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Supreme Court of the United States

OCTOBER TERM, 1948

No. 35

GEORGE T. GOGGIN, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF KESSCO ENGINEERING CORPORATION, PETITIONER,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE OF CERTAIN PRIOR WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 9, 1948.

CERTIORARI GRANTED MARCH 29, 1948.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

No. 667

GEORGE T. GOGGIN, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF KESSCO ENGINEERING CORPORATION, PETITIONER,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE OF CERTAIN PRIOR WAGE CLAIMANTS

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA

DEBTOR'S PETITION—Filed March 26, 1946

To the Honorable Judge of the District Court of the United States for the Southern District of California, Central Division. 44329-B

The Petition of Kessco Engineering Corporation a California corporation, in the County of Los Angeles District and State of California and in the business and occupation of tool and *dye* works.

Respectfully Represents: That it is a corporation duly organized and existing under and by virtue of the laws of California and has had its principal place of business for the greater portion of six months next immediately preceding the filing of this petition, at 2121 San Fernando Road, Los Angeles, California, within said judicial district; that it owes debts which it is unable to pay in full; that it is willing to surrender all its property for the benefit of its creditors; except such as is exempt by law, and desires to obtain the benefit of the Act of Congress relating to Bankruptcy;

That the Schedule hereto annexed, marked "A" and verified by your petitioner's oath, contains a full and true statement of all debts, and (so far as it is possible to ascertain) the names and places of residence of its creditors, and such further statements concerning such debts as are required by the provisions of said act

That the Schedule hereto annexed marked "B" and veri-
[fol. 3] fied by your petitioner's oath, contains an accurate inventory of all its property, both real and personal, and such further statements concerning said property as are required by the provisions of said Acts;

Wherefore, your petitioner prays that it be adjudged by the Court to be bankrupt within the purview of said Acts.

Kessco Engineering Corporation, a California corporation, Petitioner, by Tennis W. Swedell, Vice-President or Secretary. (Corporate Seal.) Cobb & Utley and Albert Lee Stephens, Jr., by ——, Attorney for Petitioner.

Oath to Petition

United States of America, Southern District of California etc. (Verified.)

[File endorsement omitted.]

[fol. 4] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF CALIFORNIA

ORDERS OF ADJUDICATION AND OF GENERAL REFERENCE—Filed March 26, 1946

At Los Angeles, in said District, on March 26, 1946,

The respective petitions of each of the petitioners in the proceedings hereinafter mentioned, filed on the respective dates hereinafter indicated, that he be adjudged a bankrupt under the Act of Congress relating to bankruptcy, having been heard and duly considered; and there being no opposition thereto;

It is adjudged that each of said petitioners is a bankrupt under the Act of Congress relating to bankruptcy; and

It is thereupon ordered that the said proceedings be, and they hereby are, referred generally to the referees in bankruptcy of this Court, whose names appear opposite the respective proceedings hereinafter mentioned, to take such further proceedings therein as are required and permitted by said Act, and that each of the said bankrupts shall henceforth attend before said referee and submit to such orders as may be made by him or by a Judge of this Court relating to said bankruptcy.

Number: 44,329-B. Title of Proceedings: Kessco Engineering Corporation, a corporation. Filed 3-26-46. Referee: Benno M. Brink, Esq., Los Angeles, Calif.

Paul J. McCormick, United States District Judge.

[File endorsement omitted.]

[fol. 5] IN UNITED STATES DISTRICT COURT

PETITION FOR ORDER TO SHOW CAUSE RE: TAX & LABOR CLAIMANTS

To the Hon. Benno M. Brink, Referee in Bankruptcy:

Comes now your petitioner George T. Goggin and respectfully represents as follows:

I

That he is the duly elected, qualified and acting Trustee in bankruptcy in the within bankruptcy proceedings.

II

That the Collector of Internal Revenue and Department of Employment of the State of California have filed certain tax claims in the within bankruptcy proceedings, each agency claiming a lien upon the assets in the hands of your Trustee; that in addition thereto certain labor claimants have asserted prior labor claims having filed their claims either through the Division of Labor Law Enforcement of the State of California or individually as follows:

Marc J. Thompson	Edward G. English
Fay Friedenthal	Joseph H. Thibodeau
Lester M. Laing	Harold L. Raoth
John C. Hawthorne	John E. Jaeger
Alvin Milfs	Joseph B. Grace
Lester Campbell	Joseph Rand Morphis
Herman Sam Watson	Henry S. Hansen
[John S. Hansen]*	John H. Muller
Leslie C. Clayton	Ralph Trotter
Gerald H. Grotbeck	Lawrence M. Marinez
Nicholas DiBarardino	Harry T. Rountree
Carl E. Englehard	Jean Ghislain.

[fol. 6]

III

That it now appears your petitioner will not have sufficient funds in the within estate to pay all of said claims in full and there is a need for determining the manner in which

* Erased in Copy.

the expenses of administration, the prior labor claims and the taxes shall be paid, and whether or not there shall be a priority of payments granted to any one or more of the claimants as described hereinabove.

Wherefore, your petitioner prays that this court issue an order directing the above named persons to appear before this Court on a day certain and show cause why the order of priority of the payment of their claims and of the expenses of administration should not be determined by this Court.

Dated this October 4, 1946.

George T. Goggin, Trustee.

Martin Gendel, Attorney for Trustee.
(Verified.)

(Endorsed:) Filed Oct. 17, 1946 at 25 Min. past 3 o'clock PM. Benno M. Brink, Referee. Florence Robinson, Clerk. —M. Filed Jan. 20, 1947 at — Min. past 5 o'clock PM. Edmund L. Smith, Clerk by F. Betz Deputy.

[fol. 7] In United States District Court

Order to Show Cause Re: Priority of Various Tax and Labor Claimants—Filed October 18, 1946

Upon reading and filing the verified petition of George T. Goggin and upon motion of Martin Gendel his counsel and good cause appearing therefor, it is hereby ordered that the persons named in said petition for order to show cause, to-wit: Collector of Internal Revenue and Department of Employment of the State of California, Marc J. Thompson, Edward G. English, Fay Friedenthal, Joseph H. Thibodeau, Lester M. Laing, Harold L. Raoth, John C. Hawthorne, John E. Jaeger, Alvin Milfs, Joseph B. Grace, Lester Campbell, Joseph Rand Morphis, Herman Sam Watson, Henry S. Hansen, [John S. Hansen]* John H. Muller, Leslie C. Clayton, Ralph Trotter, Gerald H. Grotbeck, Lawrence M. Marinez, Nicholas Di Berardino, Harry T. Rountree, Carl E. Engelhard and Jean Ghislain, appear before this Court on the 30 day of October, 1946, at the hour of 10

* Erased in copy.

o'clock a. m., or as soon thereafter as counsel can be heard, in the court room of the undersigned Referee located on the 3rd floor of the Federal Building, Temple and Spring Streets, Los Angeles, California, and then and there show cause why the petition of the Trustee, a copy of which accompanies the within order to show cause, should not be granted, and why this court should not determine the priority and method of payment of the expenses of administration, tax claimants and prior labor claimants.

[fol. 8] It is further ordered that a copy of the within order to show cause, and petition therefor, may be served upon each of the above named respondents by depositing the same in an envelope duly addressed and stamped at the addresses shown on the claim sheet now on file in the within bankruptcy proceedings, and by depositing it in the United States Mail at least five days before the date of the above hearing.

Dated this 18 day of October, 1946.

Benno M. Brink, Referee in Bankruptcy.

[Endorsed:] Filed Oct. 18, 1946 at 30 Min. Past 9 o'clock P. M. Benno B. Brink, Referee. Florence Robinson, Clerk. Filed Jan. 20, 1947 at —— Min. past 5 o'clock P. M. Edmund L. Smith, Clerk, by F. Betz, Deputy.

[fol. 9] In United States District Court

Findings of Fact and Conclusions of Law and Order—December 12, 1946

Upon reading and filing the verified petition of George T. Goggin, as Trustee in the within bankruptcy proceedings, for an order to show cause re: priorities of various tax and labor claimants, and an Order to Show Cause having been duly issued pursuant thereto, and due service having been made upon all the named respondents, and the matter having duly come on for hearing before the undersigned Referee, in his courtroom located on the 3rd floor of the Federal Building on the 30th day of October, 1946, the Trustee being represented by his counsel Martin Gendel; the respondent Collector of Internal Revenue of the United States being represented by his counsel Loren P. Oakes, and the State of California, Department of Employment, being

represented by its counsel J. Lafferty, and the Division of Labor Enforcement, Department of Industrial Relations, being represented by Edward M. Belasco, appearing on behalf of the labor claimants, and evidence having been duly introduced by stipulation, documents or oral testimony, and the matter having been duly submitted for decision, and good cause appearing therefor, the undersigned does hereby make the following Findings of Fact:

Findings of Fact

I

That prior to the commencement of the within bankruptcy proceedings, to-wit: on or about March 26, 1946, the Col- [fol. 10] lector of Internal Revenue was in physical possession of the personal property of the within bankrupt having made a seizure pursuant to the tax claims of the Collector of Internal Revenue against the bankrupt entity, which tax claims are more specifically described in Exhibit "A" which is attached hereto and made a part hereof as though set forth verbatim; that in addition to having made a physical seizure of the personal property, the Collector of Internal Revenue, prior to March 26, 1946, had filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit. The foregoing Exhibit includes items of taxes, penalties and interest to August 21, 1946, together with lien costs in the amount of $8.00, the total on such Exhibit being $40,921.94.

II

That in the within bankruptcy proceedings, the original claim filed by the Collector of Internal Revenue, and dated August 21, 1946, should be disallowed pursuant to stipulation with the Collector of Internal Revenue, and this claim is superceded by an amended claim of the Collector of Internal Revenue dated August 28, 1946, being in the gross amount of $78,865.03, and which amended claim included the items set forth in Exhibit "A" herein.

III

That on or about April 27, 1946, the Department of Employment of the State of California, filed a tax claim in

[fol. 11] the within bankruptcy, in the sum of $15,135.00, and it is further found that said tax claim was recorded as a lien on or about December 24, 1945.

IV

That in accordance with the petition of the Trustee in Bankruptcy, dated October 4, 1946, above referred to, the Labor Claimants specified in Paragraph II, had owing to them as of March 26, 1946, the date of the commencement of the within bankruptcy proceedings, prior labor claims for services rendered to the bankrupt within 90 days of bankruptcy, in the total sum of $2,838.79. That the Division of Labor, Law Enforcement, appears on behalf of all of said Labor Claimants.

V

That after the bankruptcy proceedings commenced, George T. Goggin was duly appointed as Receiver, and the personal property of the bankrupt in the hands of the Collector of Internal Revenue, as described hereinabove, was turned over to the said George T. Goggin, who accepted the terms and conditions of a telegram from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, reading as follows:

> "Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, Bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale.
>
> [fol. 12] J. P. Wenchel, Chief Counsel."

From the above findings of fact, the undersigned Referee concludes as follows:

CONCLUSIONS OF LAW

1. That expenses of administration are payable from the funds now in the hands of the Trustee in Bankruptcy.

(a) That the Trustee in Bankruptcy has now on hand a sum of approximately $31,206.20 and at this time there doesn't appear to be any additional funds available for distribution into the within estate.

2. That the Collector of Internal Revenue has a lien superior to all other claimants, upon the balance of the aforesaid funds now in the hands of the trustee which will remain after the expenses of administration are paid, by reason of the aforesaid seizure made pursuant to the tax claims which are described in Exhibit "A" hereof.

Dated this 12 day of December, 1946.

Benno M. Brink, Referee in Bankruptcy.

From the above Findings of Fact and Conclusions of Law, it is hereby ordered:

1. That from the monies in the possession of George T. Goggin, as Trustee, there shall first be paid the expenses of administration.

2. That after the payment of the expenses of adminis- [fol. 13] tration, the balance of the aforesaid funds now in the hands of the Trustee shall be paid to the Collector of Internal Revenue in partial payment of the tax claims which are described in Exhibit "A" hereof, and the interest thereon as prescribed by law.

3. That if additional money shall come into the possession of the Trustee, the Court, upon notice to all necessary and proper parties, shall determine the respective liens or priorities, if any there be, of the Collector of Internal Revenue, the prior labor claimants, the Department of Employment of the State of California and such other tax claimants who may be entitled to be heard in the matter.

4. The claim of the Collector of Internal Revenue dated August 21, 1946, is hereby disallowed, such claim having been superceded by the Collector's above amended claim of August 28, 1946, which consists in part of the items set forth on Exhibit "A" hereto.

Dated: This 12 day of December 1946.

Benno M. Brink, Referee in Bankruptcy.

[fol. 14]

Exhibit "A" to Findings of Fact

Kessco Engineering Corporation
2121 San Fernando Road, L. A.

Nature of Tax	Period		Tax	Assessed Liability Penalty	Interest	Accrued Interest to 8-21-46	5% Penalty	Total
Federal Ins. Contr.	1/¼/45	(Bal)	$2,798.14	$.....	$18.99	$221.14	$*190.86	$3,229.13
"	2/¼/45		2,103.18	.....	.....	135.52	*105.16	2,343.86
"	3/¼/45		975.42	.....	.....	30.22	* 48.77	1,054.41
"	4/¼/45		448.16	.....	2.06	12.44	* 22.51	485.17
Federal Unemploy.	1944	(Bal)	804.48	.....	.....	51.04	* 40.22	895.74
Withholding	2/¼/45		15,372.74	.....	.....	988.07	*768.64	17,129.45
"	3/¼/45		6,056.90	*1,514.23	151.42	205.75	*386.13	8,314.43
"	4/¼/45		3,918.90	*391.89	39.19	115.90	*217.50	4,683.38
" (Final)	1/¼/46	(Bal)	744.61	.....	.....	22.16	* 86.33	853.10
Misc. Photo Appl.	July & Aug '45		1,625.51	121.58	16.29	73.72	* 88.17	1,925.27
			$34,848.04	$2,027.70	$227.95	$1,855.96	$1,954.29	$40,913.94
						Plus Lien Costs		8.00
								40,921.94

[Endorsed] Filed Dec. 12, 1946, at — Min. Past 9 o'clock A.M., Benno M. Brink, Referee; Florence Robinson, Clerk.
Filed Jan. 20, 1947, at — Min. past 5 o'clock P.M., Edmund L. Smith, Clerk, By F. Betz, Deputy.

[fol. 15] IN UNITED STATES DISTRICT COURT

PETITION FOR REVIEW OF REFEREE'S ORDER OF DECEMBER 12th, 1946

Comes now the Division of Labor Law Enforcement, by and through its attorneys, Pauline Nightingale and Edward M. Belasco, and filed this, its Petition for Review of that certain order made by Referee in Bankruptcy Benno M. Brink, Esquire, and entered in the above entitled proceeding on the 12th day of December, 1946, ordering and authorizing George T. Goggin, Trustee in Bankruptcy, who now has on hand a sum of approximately $31,206.20, no other funds appearing to be available for distribution, after payment of the expenses of administration, to pay to the Collector of Internal Revenue in partial payment of his tax claims and the interest thereon the balance of said sum.

Said order reads as follows, to-wit:

"From the above Findings of Fact and Conclusions of Law, it is hereby ordered:

"1. That from the monies in the possession of George T. Goggin, as Trustee, there shall first be paid the expenses of administration.

"2. That after the payment of the expenses of administration, the balance of the aforesaid funds now in the hands of the Trustee shall be paid to the Collector of Internal Revenue in partial payment of the tax claims which are described in Exhibit "A" hereof, and the interest thereon as prescribed by law.

[fol. 16] "3. That if additional money shall come into the possession of the Trustee, the Court upon notice to all necessary and proper parties, shall determine the respective liens or priorities, if any there be, of the Collector of Internal Revenue, the prior labor claimants, the Department of Employment of the State of California and such other tax claimants who may be entitled to be heard in the matter.

"4. The claim of the Collector of Internal Revenue dated August 21, 1946, is hereby disallowed, such claim having been superseded by the Collector's above

amended claim of August 28, 1946, which consists in part of the items set forth on Exhibit 'A' hereto.

"Dated: This 12th day of December, 1946.

"Benno M. Brink (signed) "Referee in Bankruptcy."

I

The Referee in Bankruptcy erred in ordering that after the payment of the expenses of administration there shall first be paid to the Collector of Internal Revenue in partial payment of his tax claims and the interest thereon the balance of the sum of $31,206.20 remaining in the possession of the Trustee in Bankruptcy.

II

The Referee in Bankruptcy erred in basing his order upon a conclusion of law that the Collector of Internal Revenue has a lien superior to all other claimants, upon [fol. 17] the balance of the aforesaid funds now in the hands of the Trustee in Bankruptcy which will remain after the expenses of administration are paid, by reason of the aforesaid seizure made pursuant to the tax claims of the Collector of Internal Revenue. Payment on the lien of the Collector of Internal Revenue must be postponed under the provisions of Section 67c of the Bankruptcy Act, set forth in paragraph III below until after payment of certain debts: Administration costs and prior labor claims, unless the said lien was enforced by a sale by the lien holder or it was accompanied by possession of the personal property. Since there was no sale by the lien holder and since possession of the personal property was relinquished by the lien holder to the Trustee in Bankruptcy, the lien is not superior to the prior labor claimants; mere seizure by the Collector of Internal Revenue does not give him the superior priority as concluded by the Referee in Bankruptcy.

III

The Referee in Bankruptcy erred in making his said order in that he failed to order the Trustee in Bankruptcy to pay from the balance of the funds in his possession after payment of the expenses of administration the prior wage claims of the labor claimants before all other creditors of the bankrupt, including the Collector of Internal Revenue,

in conformity with the provisions of Section 67c of the Bankruptcy Act, which provides as follows:

[fol. 18] "c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter X, XI, XII, or XIII of this Act, though valid under subdivison b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act."

IV

The Referee in Bankruptcy erred in making his order in that it is based on incomplete and erroneous findings of fact. Prior to the signing of the said order your Petitioner presented to the Referee in Bankruptcy certain proposed findings of fact, but these were not included in the findings of fact. At the hearing on October 30, 1946 before the Referee in Bankruptcy the question of the retention or loss of possession of the personal property of the bankrupt by the Collector of Internal Revenue after his seizure was a major legal point at issue, and certain facts admitted to or stipulated to by counsel for the Collector of Internal Revenue and counsel for the Trustee in Bankruptcy are [fol. 19] pertinent to the question of such possession. Your Petitioner respectfully urges that these facts should have been considered by the Referee in Bankruptcy in the making of his said order. The two factual situations are illustrated below in the proposed Findings of Fact submitted by your Petitioner and are as follows:

"Proposed Findings of Fact

"I"

"That prior to the commencement of the within bankruptcy proceedings, to-wit: on or about March 26, 1946, the Collector of Internal Revenue was in physical posses-

sion of the personal property of the within bankrupt having made a seizure pursuant to the tax claims of the Collector of Internal Revenue against the bankrupt entity, which tax claims are more specifically described in Exhibit 'A' which is attached hereto and made a part hereof as though set forth verbatim; that in addition to having made a physical seizure of the personal property, the Collector of Internal Revenue, prior to March 26, 1946, had filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit; that pursuant to its legal rights and remedies by virtue of the above seizure the Collector of Internal Revenue conducted a sale of this property, receiving bids thereon, but that the sale was not completed because the price obtainable was unsatisfactory to the Collector of Internal Revenue; that a second sale by the Collector of Internal Revenue was instituted but [fol. 20] abandoned when the Trustee in Bankruptcy persuaded the Collector of Internal Revenue to turn over to the Trustee in Bankruptcy the said personal property upon the assurance that he, the Trustee in Bankruptcy, could obtain a greater sale price for the said property under a Trustee's sale. The foregoing Exhibit includes items of taxes, penalties and interest to August 21, 1946, together with lien costs in the amount of $8.00, the total on such Exhibit being $40,921.94.

"Proposed Findings of Fact

"V"

"That after the bankruptcy proceedings commenced, George T. Goggin was duly appointed as Receiver; that following conversations between said George T. Goggin and counsel in the Los Angeles office of the Collector of Internal Revenue relating to the turning over of the personal property of the bankrupt to George T. Goggin, the following telegram was sent from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, to the Los Angeles office of the Collector of Internal Revenue:

"'Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien

to attach to proceeds from sale subject to Trustee's expenses including costs of sale.

J. P. Wenchel, Chief Counsel.'

[fol. 21] That the contents of the above telegram were imparted by telephone to a secretary in the office of said George T. Goggin; that no formal acceptance or acknowledgment was made by said George T. Goggin, no notices given to any creditors or other interested parties of the telegram, and no notice given at the time of the Trustee's sale of the contents of the telegram."

It is the contention of your Petitioner that: *First*, the actions of the attorneys for the Collector of Internal Revenue were not sufficient to constitute an agreement binding on all other interested parties in this bankrupt matter to the effect that the lien of the Collector of Internal Revenue would attach to the proceeds of the Trustee's Sale; and *Second*, no matter how formal an agreement of this type was it could not circumvent the provisions of Section 67c of the Bankruptcy Act. Therefore it is submitted that the Findings of Fact as they now stand are incorrect.

V

The Referee in Bankruptcy erred in making his Order in that he allowed expenses of administration as a priority over the lien holder, but did not allow the prior labor claims as a priority over the lien holder. In Section 67c of the Bankruptcy Act we find the words ". . . shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of Section 64 of this Act, . . .". If the lien was insufficient to precede the expenses of ad- [fol. 22] ministration, then *ipso facto* it was insufficient to precede the prior labor claims, since these two classes of debts are treated in the conjunctive and stand together. In the instant case to allow otherwise would be to make the Trustee in Bankruptcy a commission agent for the lien holder and not the representative of all the creditors; in short, as the Order now stands the Trustee in Bankruptcy conducted a lien sale for the benefit of the Collector of Internal Revenue. Once the Collector of Internal Revenue relinquished possession of the property to the Trustee in Bankruptcy and the property was liquidated, both classes

of debts mentioned above have preference in payment and not just the one of them so ordered.

Wherefore, your Petitioner prays that the said Order be reviewed and reversed, and a proper Order made giving the prior wage claims priority in payment over the lien claims of the Collector of Internal Revenue, and for such other and further relief, decrees and Orders as shall be meet in the premises.

Dated: Dec. 17, 1946.

Respectfully submitted, Edward M. Belasco, Attorney, Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

(Endorsed): Filed Dec. 17, 1946, at 50 min. past 2 o'clock P. M. Benno M. Brink, Referee Florence Robinson, Clerk. Filed Jan. 20, 1947, at — min. past 5 o'clock P. M. Edmund L. Smith, Clerk by F. Betz, Deputy.

[fol. 23] IN UNITED STATES DISTRICT COURT

REFEREE'S CERTIFICATE ON PETITION FOR REVIEW OF ORDER IN RE DISBURSEMENT OF ASSETS OF ESTATE—Filed January 20, 1947

To the Honorable Campbell E. Beaumont, Judge of the Above Entitled Court:

I, Benno M. Brink, one of the Referees in Bankruptcy of said Court, before whom the above entitled matter is pending under an order of general reference, do hereby certify to the following:

The Division of Labor Law Enforcement of the State of California, hereinafter called the "petitioner on review", has duly filed its petition for the review of an order made by your Referee in this matter on December 12, 1946, in which he directed George T. Goggin, the trustee in this case, to distribute to the Collector of Internal Revenue all of the funds remaining in his possession in this matter, after the payment of the expenses of administration in the case, as allowed by the Court.

The trustee in this matter has liquidated all of the assets which have come into his possession and the funds which he has on hand are insufficient to pay in full the expenses of administration, the lien claims and the prior labor and prior tax claims in the case. The Collector of Internal Revenue and the Department of Employment of the State of California assert liens which were in effect at the time [fol. 24] of the commencement of this proceeding.

On October 17, 1946, the trustee filed his petition for an order to show cause requiring the lien claimants and the prior labor claimants, who are now all represented by the petitioner on review, to show cause why an order should not be made by your Referee determining the manner in which the trustee should disburse the funds in his possession. An order to show cause was issued on the said petition on October 18, 1946, and on October 30, 1946, a hearing was had before your Referee in the matter.

At said hearing it was conceded by all parties that at the time of the commencement of this proceeding, the Collector of Internal Revenue was in physical possession of all the assets later liquidated by the trustee in this case and it was further conceded that the Collector, at said time, had a valid lien on such assets superior to all other claimants in this matter. However, the petitioner on review contended that, after the commencement of this proceeding, the Collector, by surrendering the physical possession of the said assets to the then receiver in this case, lost the superior position which his lien had theretofore enjoyed, so far as the prior labor claimants in this case are concerned, and that, under Section 67(c) of the Bankruptcy Act, the lien of the Collector is subject to the payment of the prior labor claims in this case. Your Referee overruled the contentions of the petitioner on review and held that, under [fol. 25] the terms and conditions of the relinquishment by the Collector to the then receiver in this matter of the physical possession of the aforesaid assets, the Collector has a lien on the proceeds of the trustee's sale, superior to all other claimants, and subject only to the payment of the trustee's expenses, or, in other words, the expenses of administration as allowed by the Court. On December 12, 1946, your Referee signed and filed his formal findings of

fact, conclusions of law and order in the matter. It is from said order that this review is taken.

The Questions Presented

The sole question presented by this review is this: Does the Collector of Internal Revenue have a lien, superior to all other claimants, on the funds which will remain in the hands of the trustee in bankruptcy in this case, after the expenses of administration in this matter, as allowed by the Court, have been paid?

In its petition for review, the petitioner on review also makes the contention that, since your Referee directed that the expenses of administration in this matter should be paid before payment was made to the Collector of Internal Revenue on his lien, your Referee should likewise have directed, under the provisions of Section 67(c) of the Bankruptcy Act, that the claims of the prior labor claimants be paid. This contention of the petitioner on review arises from a misconception of your Referee's order in the mat-[fol. 26] ter. Your Referee did not direct the payment of the expenses of administration pursuant to Section 67(c) of the Bankruptcy Act. Your Referee ordered the expenses of administration to be paid, in advance of payment being made to the Collector of Internal Revenue, for the reason that the terms and conditions under which the trustee acquired possession of the assets which he later liquidated, as will hereinafter appear, provided for the payment of the trustee's expenses, including costs of sale. Your Referee construed the said words, "trustee's expenses, including costs of sale", to mean the expenses of administration in the case, as allowed by the Court.

The Evidence

The following is a summary of the evidence in this matter:

This proceeding began on March 26, 1946. On that date all of the assets, later liquidated by the trustee, were in the physical possession of the Collector of Internal Revenue. The Collector had previously made a seizure of the said assets pursuant to certain tax claims against the bankrupt, which tax claims are specifically described in Exhibit "A" of your Referee's findings of fact, conclusions of

law and order, a true copy of which is going up with this certificate. In addition to having made a physical seizure of the said assets, the Collector of Internal Revenue, prior to the commencement of this bankruptcy proceeding, had [fol. 27] filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit "A". Pursuant to his legal rights and remedies, by virtue of the said seizure, the Collector of Internal Revenue had conducted a sale of the said assets and had received bids thereon, but the said sale was not completed because the price obtainable was unsatisfactory to the Collector. A second sale by the Collector was instituted but was abandoned when the said assets were relinquished to the receiver in this matter, as hereinafter set forth.

On March 26, 1946, the day this proceeding began, George T. Goggin, now trustee, was appointed receiver in this matter. He qualified as such receiver on March 28, 1946. Upon his appointment and qualification, the said receiver contacted the office of the Collector of Internal Revenue and conversations were had between the receiver and counsel in the Los Angeles office of the Collector relating to the turning over of the said assets by the Collector to the receiver. Thereafter, the following telegram was received by the Los Angeles office of the Collector of Internal Revenue from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue:

> "Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale.
> [fol. 28] J. P. Wenchel, Chief Counsel."

The contents of the said telegram were imparted by telephone to the office of the said receiver. No formal acceptance or acknowledgment thereof was made by the receiver. No notice of the telegram or of its contents was given to any of the creditors or other parties in interest in this matter and no notice thereof was given at the time of the trustee's sale of the aforesaid assets. After the said telegram had been imparted to the office of the said receiver, as aforesaid, the said receiver, with full knowledge of the

said telegram and of its contents and without any objection thereto, took over the possession of the said assets from the Collector of Internal Revenue. Later the said receiver, in his capacity as trustee, caused the said assets to be sold at public auction, pursuant to the order of this Court.

Findings of Fact, Conclusions of Law and Order of the Referee

A true copy of your Referee's findings of fact, conclusions of law and order in this matter is going up with this certificate.

Papers Submitted

For the information of the Court I hand up the following papers:

1. Petition for Order to Show Cause re: Tax & Labor Claimants, filed October 17, 1946.

[fol. 29] 2. Order to Show Cause re: Priority of Various Tax and Labor Claimants, dated October 18, 1946.

3. A true copy of Findings of Fact and Conclusions of Law and Order, filed December 12, 1946.

4. Petition for Review of Referee's Order of December 12th, 1946, filed December 17, 1946.

Respectfully submitted this 20 day of January, 1947.

Benno M. Brink, Referee in Bankruptcy.

[File endorsement omitted.]

[fol. 30] In United States District Court

Notice of Hearing of Petition for Review of Referee's Order of December 12th, 1946—Filed February 6, 1947

To: Division of Labor Law Enforcement, and to Pauline Nightingale and Edward M. Belasco, its attorneys; and to the Collector of Internal Revenue, and to Eugene Harpole and Loren P. Oakes, his attorneys:

You and Each of You Will Please Take Notice, and each of you is hereby notified that on Monday, February 24,

1947, at the hour of 10 o'clock a. m. of said date or as soon thereafter as counsel may be heard, at the courtroom of the Hon. Campbell E. Beaumont, Second Floor, Federal Building Temple and Spring Streets, Los Angeles, 12, California, the Petition for Review of the Order of the Hon. Benno M. Brink, Referee in Bankruptcy, dated December 12, 1946, will be brought on for hearing.

Dated at Los Angeles, February 5, 1947.

Martin Gendel, Attorney for Trustee.

(Affidavit of Service by Mail.)

[File endorsement omitted.]

[fol. 31] In United States District Court

Order Confirming Referee's Order—March 31, 1947

The petition of the Division of Labor Law Enforcement for review of Referee's order of December 12, 1946, having been heard by the Court, and counsel having argued the same and filed written argument, and the Court having duly considered the same, and being fully advised as to the facts and the law,

It Is Now Ordered that the said order of the Referee be, and it hereby is, confirmed in all respects, and the Court adopts the findings of fact and conclusions of law of the Referee as its own.

[fol. 32] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed April 28, 1947

To the Honorable Campbell E. Beaumont, Judge of the Above Entitled Court; to the Honorable Benno M. Brink, Referee in Bankruptcy of the Above Entitled Court: To Edmund L. Smith, Clerk of Said Court:

You and each of you will please take Notice, and Notice is hereby given, that the Division of Labor Law Enforcement, State of California, statutory assignee of certain prior wage claimants in the above entitled bankruptcy proceeding, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit from the certain Minute Order dated March 31, 1947 entered in the Bankruptcy Docket confirming, in all respects the Order of the Referee in Bankruptcy, of December 12, 1946, and adopting the Findings of Fact and Conclusions of Law of the Referee as the Court's own.

Dated: April 28, 1947.

Edward M. Belasco, Attorney for Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

[File endorsement omitted.]

[fol. 33] IN UNITED STATES DISTRICT COURT

SUPPLEMENT TO REFEREE'S CERTIFICATE ON PETITION FOR REVIEW OF ORDER IN RE DISBURSEMENT OF ASSETS OF ESTATE—Filed May 6, 1947

To the Honorable Campbell E. Beaumont, Judge of the Above Entitled Court:

I, Benno M. Brink, one of the Referees in Bankruptcy of said Court, before whom the above entitled matter is pending under an order of general reference, do hereby supplement by the following information my Referee's Certificate on Petition for Review of Order in re Disbursement of Assets of Estate heretofore filed with the Clerk of the above entitled Court on January 20, 1947.

The prior labor claims involved in the above entitled

matter and referred to in my Referee's Certificate on Petition for Review of Order in re Disbursement of Assets of Estate are listed herewith:

Division of Labor Law Enforcement		$448.48
Frank C. Berger	$96.00	
Glenn Lynn Legg	134.88	
R. C. Monroe	115.20	
Charles M. Weaver	102.40	
Marc J. Thompson		92.00
Faye Friedenthal		100.00
Edward C. English		256.08
Joseph H. Thibodeau		209.19
Lester M. Laing		288.85
Harold L. Raoth		111.60
John C. Hawthorne		79.20
John E. Jaeger		111.60

[fol. 34]

Alvin Milfs	104.40
Joseph B. Grace	83.20
Lester Campbell	93.80
Joseph Rand Morphis	190.00
Herman Sam Watson	72.00
Henry S. Hansen	64.00
John H. Muller	81.60
Leslie C. Clayton	123.75
Ralph Trotter	118.80
Gerald H. Grotbeck	108.00
Lawrence M. Marinez	97.20
Nicholas Di Barardino	114.40
Harry T. Rountree	125.52
Carl E. Engelhard	99.20
Jean Chislain	104.40
John R. Medberry	108.00
John Melzer	39.60
Total amount of prior labor claims	$3,424.87

Respectfully submitted this 6 day of May, 1947.

Benno M. Brink, Referee in Bankruptcy.

[File endorsement omitted.]

[fol. 35] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA

[Title omitted]

ORDER OF JUDGE ON PETITION FOR REVIEW OF REFEREE'S ORDER —May 21, 1947

At Los Angeles, in said District on the 21st day of May, 1947,

Upon the Petition for Review of the Division of Labor Law Enforcement, State of California, filed herein on December 17, 1946; and upon the Certificate of Referee in Bankruptcy, Benno M. Brink, filed herein on January 20, 1947: and upon all proceedings had before the Referee as appears from the Certificate and his Order, dated December 12, 1946, in which he held that after the payments of the expenses of administration the balance of the funds in the hands of the Trustee in Bankruptcy shall be paid to the Collector of Internal Revenue in partial payment of the tax claims; and upon the hearing held before this Court on February 24, 1947, the Trustee being represented by his counsel, Martin Gendel; the respondent Collector of Internal Revenue of the United States being represented by his counsel, Loren P. Oakes; the petitioner Division of Labor Law Enforcement of the State of California, being repre-[fol. 36] sented by its counsel Edward M. Belasco, the petitioner appearing on behalf of all prior wage claimants, said prior wage claims being set forth in the Supplement to Referee's Certificate on Petition for Review of Order in Re Disbursement of Assets of Estate, filed herein on May 6, 1947; and a Minute Order of this Court having heretofore been entered on March 31, 1947;

It is ordered that the Order of the Referee herein of December 12, 1946, is in all respects confirmed, and the Findings of Fact and Conclusions of the Referee are adopted as the Court's own.

Dated: May 21, 1947.

Campbell E. Beaumont, United States District Judge.

Judgment entered May 21, 1947. Docketed May 21, 1947. C. O. Book 43, Page 265. Edmund L. Smith, Clerk, by R. B. Clifton, Deputy.

[File endorsement omitted.]

[fol. 37] IN UNITED STATES DISTRICT COURT

PETITION FOR PERMISSION TO APPEAL IN FORMA PAUPERIS—
Filed April 25, 1947

STATE OF CALIFORNIA,
County of Los Angeles, ss:

I, Edward M. Belasco, being first duly sworn, depose and say:

That I am an attorney employed by the Division of Labor Law Enforcement, Department of Industrial Relations, State of California;

The the Division had assigned to it certain wage claims in the sum of $448.48 representing unpaid wages of four workers whose employer had been the bankrupt above; that in accordance with the provisions of Section 100 of the Labor Code the Division joined these claimants and filed on their behalf in the above-entitled matter Proof of Unsecured Debt in Bankruptcy (Priority);

That the wage claims are as follows: Frank G. Berger, Tool Maker, $96; Glenn Lynn Legg, Tool and Die Maker, $134.88; R. G. Monroe, Die Maker, $115.20; Charles M. Weaver, Tool and Die Maker, $102.40.

That in accepting the wage claims of the four laborers listed above it was determined that these men should not be required to obtain private counsel to recover the unpaid wages due them; that the Division's policy, upheld by the Appellate Courts of California, is that no working people supporting themselves and their families on the ordinary salary paid working people should be required to spend their own money to recover unpaid wages; that under [fol. 38] every-day conditions each worker needs all of his current earnings to meet ordinary living expenses. In MacDonald v. Neuner, 5 Cal. App. (2d) 751, where this matter was questioned the Court stated:

"Appellant's final contention is that respondent failed to show at the trial that his assignors were financially unable to employ counsel. This point, is based upon Act 4089, Deering's General Laws, which in defining the duties of the labor commissioner provides that he is to prosecute actions for wages and other demands 'of persons who in the judgment of the commissioner or his said representative are financially unable to em-

> ploy counsel'. The trial court made no finding on this subject; but evidence was introduced at the trial that the labor commissioner had made an investigation and had determined that such assignors were financially unable to employ counsel, and an allegation to that effect is contained in the complaint. . . . A finding to that effect was not at all necessary to an adjudication of the merits of the action."

That the Division of Labor Law Enforcement, more commonly known to the public as the "Labor Commissioner," is a statutory assignee of claims filed with it, whose only function in taking such assignment is to obtain the unpaid wages of a worker without any financial charge to the worker. No fees or charges are made to the worker for any services rendered, and if collection be through administrative procedure or civil action the worker receives all of the [fol. 39] wages collected; that Section 101 of the Labor Code states in part: "When a civil action is brought by the Division no court costs of any nature shall be payable by the Division;" that the Division of Labor Law Enforcement does not have any appropriation from the State Legislature nor from the State Department of Finance for court costs, or costs of appeal; that the Division has not had in the past, nor does not have now, any funds set aside for such costs; that the Division is only authorized under Section 101 to be charged with keeper's fees, mileage fees, and storage charges payable to any Sheriff, Marshal or Constable.

Your Petitioner respectfully urges that the Court take a liberal view of this situation and grant this request for the right to appeal without the payment of costs, on the basis that the statute 28 U. S. C. A. 832, does not require one to be absolutely destitute, or so impoverished as to be a public charge, to come within the purview of the state statute; that the word "pauper" be deemed to mean one upon whom it would be a great hardship if he be required to borrow money or exhaust his meagre savings to pay court costs.

That the question on appeal in this bankruptcy matter concerns an interpretation of Section 67c of the Bankruptcy Act as amended in 1938 determining a point of law of first impression, the meaning of the word "possession" as used

in the said section; that the said issue is of vital interest not only to these workers but to all prior wage claimants in bankruptcy cases; that this question should be passed on by the Circuit Court of Appeals.

[fol. 40] That, therefore, the undersigned requests that the Division of Labor Law Enforcement, statutory assignee of the prior wage claimants, be allowed to prosecute his appeal to conclusion without being required to pay fees or costs, or any security therefor.

Dated: April 24, 1947.

Respectfully submitted, Edward M. Belasco, Attorney, Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

Subscribed and sworn to before me this 24th day of April, 1947. Marguerite Reese, Notary Public in and for the County of Los Angeles, State of California. My Commission expires June 15, 1947. (Seal.)

[File endorsement omitted.]

[fol. 41] In United States District Court

Affidavit for Permission to Appeal in Forma Pauperis—Filed April 25, 1947

State of California,
County of Los Angeles, ss:

I, Frank G. Berger, being first duly sworn, depose and say:

That I am a citizen of the United States, entitled to commence or defend any suit or action, civil or criminal, in any court of the United States;

That because of my poverty I am unable to pay the costs of an appeal or to give security for the same;

That I believe I am entitled to the redress I seek by an appeal in the above entitled matter;

That a description of the nature of the appeal is set forth in an accompanying affidavit by Edward M. Belasco, attorney for the Division of Labor Law Enforcement of the State of California, to whom I have assigned my wage claim

against the above entitled bankrupt; that Edward M. Belasco has no financial interest in my bankruptcy claim and that any and all money recovered by the Division in my behalf will go to me, without any costs or charges of any nature whatsoever by the aforesaid Division or its attorneys;

That I live at 15445 Roxford Street, San Fernando, California; that I am employed as a machinist at the rate of $1.50 per hour; that my weekly earnings are approximately $57 net take home pay; that I am married and my wife is not [fol. 42] working; that out of the aforesaid salary I support myself, my wife, my three minor children and my mother, all of whom live at the above address; that I am purchasing this home by making payments of $25 per month; that it cost me $4500 in 1942 and there now remains an $1800 balance owed; that I own a 1940 Pontiac automobile, which is used in my work; that I own no other real property, have no other source of income, own no stocks or bonds, and have less than $125 in the bank; that one of my children is now under medical care and what small savings I have will be used in payment of medical expenses.

Frank G. Berger.

Subscribed and sworn to before me this 23 day of April, 1947. L. A. Shelton, Notary Public in and for the County of Los Angeles, State of California. My Commission expires May 17, 1949. (Seal.)

[File endorsement omitted.]

[fol. 43] In United States District Court

Affidavit for Permission to Appeal in Forma Pauperis—Filed April 25, 1947

State of California,
County of Los Angeles, ss:

I, Charles M. Weaver, being first duly sworn, depose and say:

That I am a citizen of the United States, entitled to commence or defend any suit or action, civil or criminal, in any court of the United States;

That because of my poverty I am unable to pay the costs of an appeal or to give security for the same;

That I believe I am entitled to the redress I seek by an appeal in the above entitled matter;

That a description of the nature of the appeal is set forth in an accompanying affidavit by Edward M. Belasco, attorney for the Division of Labor Law Enforcement of the State of California, to whom I have assigned my wage claim against the above entitled bankrupt; that Edward M. Belasco has no financial interest in my bankruptcy claim and that any and all money recovered by the Division in my behalf will go to me, without any costs or charges of any nature whatsoever by the aforesaid Division or its attorneys;

That I live at 506 North Jackson Street, Glendale, California; that I am employed as a tool maker; that my weekly take home pay is $66.89; that I have one dependent besides myself who is supported out of the above salary; that my rent is $20 per month; that I own a 1939 Buick automo-
[fol. 44] bile, which is used in my work; that I have approximately $450 in my savings account; that I have no other property of any kind nor other source of income.

Charles M. Weaver.

Subscribed and sworn to before me this 18 day of April, 1947. Wesley S. Walder, Notary Public in and for the County of Los Angeles, State of California. My Commission expires Aug. 4, 1950. (Seal.)

[File endorsement omitted.]

[fol. 45] IN UNITED STATES DISTRICT COURT

AFFIDAVIT FOR PERMISSION TO APPEAL IN FORMA PAUPERIS—Filed April 25, 1947

STATE OF CALIFORNIA,
County of Los Angeles, ss:

I, R. G. Monroe, being first duly sworn, depose and say:

That I am a citizen of the United States, entitled to commence or defend any suit or action, civil or criminal, in any court of the United States;

That because of my poverty I am unable to pay the costs of an appeal or to give security for the same;

That I believe I am entitled to the redress I seek by an appeal in the above entitled matter;

That a description of the nature of the appeal is set forth in an accompanying affidavit by Edward M. Belasco, attorney for the Division of Labor Law Enforcement of the State of California, to whom I have assigned my wage claim against the above entitled bankrupt; that Edward M. Belasco has no financial interest in my bankruptcy claim and that any and all money recovered by the Division in my behalf will go to me, without any costs or charges of any nature whatsoever by the aforesaid Division or its attorneys;

That I live at 2408 West Avenue 32, Los Angeles 41, California; that my occupation is tool and die maker; that at present I am not working and, when working, support my sister; that my rent is $40 per month; that I have no savings account; that I own no real property and have no other [fol. 46] source of income.

R. G. Monroe.

Subscribed and sworn to before me this 23 day of April, 1947. Laura F. Coolidge, Notary Public in and for the County of Los Angeles, State of California. My Commission expires Oct. 21, 1949. (Seal.)

[File endorsement omitted.]

[fol. 47] IN UNITED STATES DISTRICT COURT

ORDER GRANTING PERMISSION TO APPEAL IN FORMA PAUPERIS—Filed April 25, 1947

Good cause appearing from the foregoing Affidavits of the three prior wage claimants and upon the application of Edward M. Belasco, Attorney, on behalf of the Division of Labor Law Enforcement, State of California, and there appearing to be merit in the appeal proposed, and that it is made in good faith,

It is hereby ordered, that the Division of Labor Law Enforcement, State of California herein may commence and prosecute to conclusion the above-entitled appeal to the United States Circuit Court of Appeals (including all appellate proceedings), without being required to prepay fee or costs or giving security therefor.

Campbell E. Beaumont, United States District Judge.

Dated: April 25, 1947.

[File endorsement omitted.]

[fol. 48] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed May 21, 1947

To the Honorable Campbell E. Beaumont, Judge of the above entitled Court; To the Honorable Benno M. Brink, Referee in Bankruptcy of the above entitled court; To Edmund L. Smith, Clerk of said Court.

You and each of you will please take Notice, and Notice is hereby given, that the Division of Labor Law Enforcement, State of California, statutory assignee of certain prior wage claimants in the above entitled bankruptcy proceeding, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Circuit from the Order of Judge on Petition for Review of Referee's Order, dated May 21, 1947 and entered in Civil Order Book 43, at Page 265, confirming in all respects the Order of the Referee in Bankruptcy, of December 12, 1946, and adopting the

Findings of Fact and Conclusions of Law of the Referee as the Court's own.

Dated: May 21, 1947.

Edward M. Belasco, Attorney for Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

[File endorsement omitted.]

[fol. 49] IN UNITED STATES DISTRICT COURT

APPELLANT'S STATEMENT OF POINTS—Filed May 26, 1947

Comes now the Appellant, Division of Labor Law Enforcement, appearing on behalf of all prior wage claimants, and states that the Points upon which it intends to rely in the Appeal in this proceeding are as follows:

1. The Court erred in confirming the Order of the Referee herein, on December 12th, 1946, and adopting the Findings of Fact and Conclusions of Law of the Referee as the Court's own.

2. The Court erred in ordering that after the payment of the expenses of administration there shall be first paid to the Collector of Internal Revenue in partial payment of his tax claims and the interest thereon the balance of $31,231.20 remaining in possession of the Trustee in Bankruptcy.

3. The Court's Order is erroneous in that it is based upon a Conclusion of Law that the Collector of Internal Revenue has a lien superior to all other claimants.

4. The Court erred in failing to reverse the Order of the Referee and order the Trustee in Bankruptcy to pay from the balance of the funds in the Trustee's possession, after payment of the expenses of administration, the prior wage claims of the labor claimants before all other creditors of the bankrupt, including the Collector of Internal Revenue.

5. The Court erred in confirming the Referee's Order in that said order was based on incomplete Findings of Fact; [fol. 50] that said Findings of Fact failed to include all

the pertinent evidentiary matter set forth under the heading "*The Evidence*" in the Referee's Certificate on Petition for Review of Order in Re Disbursement of Assets of Estate.

6. The Court erred in not holding that the Collector of Internal Revenue lost the element of possession necessary under Section 67c of the Bankruptcy Act to avoid the postponement of payment of the statutory lien to prior wage claims.

7. The Court erred in confirming the Referee's Order in that said Order allowed expenses of administration as a priority over the statutory lien of the Collector of Internal Revenue but did not allow the same priority to the prior wage claims, despite the fact that expenses of administration and prior wage claims are treated in the conjunctive in Section 67c of the Bankruptcy Act.

8. The Court erred in not holding that a private agreement between the Collector of Internal Revenue and the Trustee in Bankruptcy was ineffectual in extending the statutory lien to the proceeds of the Trustee's sale to defeat the priority in payment of the prior wage claimants, under the provisions of Section 67c of the Bankruptcy Act.

Dated: May 26, 1947.

Edward M. Belasco, Attorney for Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

(Affidavit of Service by Mail.)

[File endorsement omitted.]

[fol. 51] IN UNITED STATES DISTRICT COURT

APPELLANT'S DESIGNATION OF THE RECORD ON APPEAL—Filed May 26, 1947

Appellant, claimant in the above entitled proceeding, designates the following portions of the record on appeal in the above entitled proceeding:

1. Petition in Bankruptcy.

2. Adjudication and Order of Reference.

3. Petition for Order to Show Cause Re: Tax & Labor Claimants.

4. Order to Show Cause Re: Priority of Various Tax and Labor Claimants.

5. Findings of Fact and Conclusions of Law and Order of Referee in Bankruptcy.

6. Petition for Review of Referee's Order of December 12th, 1946.

7. Referee's Certificate on Petition for Review of Order in Re Disbursement of Assets of Estate.

8. Notice of Hearing of Petition for Review of Referee's Order of December 12th, 1946.

9. Minute Order of the United States District Judge entered on March 31st, 1947.

10. Petition for Permission to Appeal in Forma Pauperis and the three accompanying Affidavit- for Permission to Appeal in Forma Pauperis.

11. Order Granting Permission to Appeal in Forma Pauperis

12. Notice of Appeal, dated April 28th, 1947.

[fol. 52] 13. Supplement to Referee's Certificate on Petition for Review of Order in Re Disbursement of Assets of Estate.

14. Order of Judge on Petition for Review of Referee's Order.

15. Notice of Appeal, dated May 21st, 1947.

Dated: May 26, 1947.

Edward M. Belasco, Attorney for Division of Labor Law Enforcement, Department of Industrial Relations, State of California.

(Affidavit of Service by Mail).

[File endorsement omitted.]

[fol. 53] IN UNITED STATES DISTRICT COURT

ORDER EXTENDING TIME FOR FILING RECORD AND DOCKETING APPEAL—Filed June 9, 1947

It appearing that an Order Granting Permission to Appeal in Forma Pauperis having been filed in the above matter by the Division of Labor Law Enforcement on April 25, 1947, and,

It appearing that a Notice of Appeal having been filed by the Division of Labor Law Enforcement on April 28, 1947, from the Minute Order dated March 31, 1947, and entered in the Bankruptcy Docket, and a Notice of Appeal having been filed by the Division of Labor Law Enforcement on May 21, 1947, from the Order of Judge on Petition for Review of Referee's Order from the Minute Order, dated May 27, 1947, and entered in Civil Order Book 43, at Page 265, and

It further appearing that the appellant herein, the Division of Labor Law Enforcement, requires additional time within which to obtain from the Clerk of this Court, the record on appeal, and for the filing and docketing of the same;

Now, Therefore, on Motion of Edward M. Belasco, Esquire, Attorney for the Division of Labor Law Enforcement herein, and for good cause appearing therefor,

It Is Ordered that the Division of Labor Law Enforcement may have, pursuant to Rule 73 of the Federal Rules of Civil Procedure, 90 days from April 28, 1947, within which to file the record on appeal and docket the appeal.

Dated: June 9, 1947.

Campbell E. Beaumont, United States District Judge.

[File endorsement omitted.]

[fol. 54] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 55] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Before Mathews, Stephens and Orr, Circuit Judges

ORDER OF SUBMISSION—November 7, 1947

Ordered appeal herein argued by Mr. Edward M. Belasco, counsel for appellant, and by Mr. Fred Youngman, Special Assistant to the Attorney General, counsel for appellee, Collector of Internal Revenue, and submitted to the Court for consideration and decision.

[fol. 56] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Before Mathews, Stephens and Orr, Circuit Judges

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—December 9, 1947

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[fol. 57] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 11669

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, Statutory Assignee, etc., Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Sixth Collection District of California, Appellees

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

OPINION—December 9, 1947

Before Mathews, Stephens and Orr, Circuit Judges

STEPHENS, Circuit Judge:

The Kessco Engineering Corporation, a California corporation, brought a voluntary petition in bankruptcy, and orders of adjudication and general reference were made on March 26, 1946. At that time the Collector of Internal Revenue had physical possession of the assets of said bankrupt pursuant to certain tax claims, notices of such liens having been filed. The property was put up for sale, but the sale was never completed because the price obtainable was unsatisfactory. The collector then relinquished the assets to the receiver in bankruptcy under an alleged agreement made by and between an official of the Bureau of Internal Revenue and the said receiver, George T. Goggin, in the following circumstances. The Los Angeles office of the collector was contacted in regard to the assets and their sales value by Goggin. A telegram was thereafter sent by the Bureau to the Los Angeles office as follows: "Reference to telephone conversation today with Mr. Webb [member of [fol. 58] the Los Angeles office of Internal Revenue] relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of

sale." The information as to these transactions were received, but no formal acceptance or acquiescence by the receiver was ever made. No notice thereof was given to the creditors or other parties in interest, nor was any notice of an intended trustee's sale ever given them. The receiver, with knowledge of the telegram, took physical possession of the assets from the collector and later in the capacity as trustee caused the assets to be sold at public auction. What notice, if any, was given does not appear in the record. Prior wage claimants filed their wage claims against the assets through the Division of Labor Law Enforcement of California. The referee put the government's claim ahead of the wage claims to the same extent as though the lien on the property followed the proceeds of its sale. The district court confirmed, and the labor claimants appeal through the California Division of Labor.

The appellant takes the position that by surrendering possession of the assets to the receiver, the collector lost the superior position which he had theretofore enjoyed. It is contended that the coll-ctor, not having enforced his lien by sale, subjected himself and his claim to the provisions of Section 67(c) of the Bankruptcy Act [11 U.S.C.A. § 107c (1946)] when he appeared in the proceedings and voluntarily surrendered possession of personal property to the trustee, and that the alleged agreement heretofore detailed has no legal binding effect on statutory rights of prior wage claimants. It is also urged that, since the referee directed payment of expenses of administration prior to payment of the collector's lien, Section 67(c) of the Act makes it obligatory to also pay the labor claims before payment of the government's claim.

The referee's order and judgment in the district court upheld the superiority of the lien and approved the action on the agreement.

The appellees, in support of the judgment, urge that the agreement or conditions attached by the government to the release and sale of the personal property protected them against loss of superior position. The determination of this question rests upon the construction of Section 67(c) [fol. 59] of the Bankruptcy Act, which provides as follows: "Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, XIII of this Act, though valid under subdivision

b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by *possession* [emphasis ours] of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment of the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payments to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act." Section 64a of the Act [11 U. S. C. A. § 104a (1946)] provides, respectively, for priority of expenses of administration and for wages of a restricted amount earned within a given time before bankruptcy proceedings, to be paid in advance of payment of dividends to creditors.

At the time the proceedings began, the collector had possession of the assets, but he subsequently relinquished them to the receiver and trustee in the already mentioned circumstances. Did the lien follow and attach to the sale proceeds?

The appellants contend that possession under the statute means *actual* possession prior to and subsequent to the filing of the petition in bankruptcy, whereas appellees contend that actual possession, which was enjoyed at the time the action in bankruptcy was commenced, need not be retained in order to protect priority in payment.

We agree with the Second Circuit in City of New York v. Hall, 139 Fed. 2d 935, in the holding that "possession" as used in Section 67(c) means actual possession, the purpose being to protect and give warning to creditors. In the instant case the government had actual possession, but it surrendered that possession by virtue of a bargain with the receiver without taking into account the wage and creditor claimants. The Act provides that wage claims come ahead of the government lien in distribution of the proceeds of sale of property not in possession of the government lien holder. The government lien holder must either sell the property under its lien or eventually surrender it into the [fols. 60-61] bankruptcy proceedings. We find no authority whatever for the proposition that the government can turn the property over to the trustee under a consent based upon the receiver's assurance that the lien shall continue upon the property and also upon the money it may bring when

sold as a part of the bankruptcy estate. It is our opinion that the wage claimants had certain statutory rights at the inception of the bankruptcy proceedings, and such rights remained throughout the proceedings, modified by the actual possession of the assets. The fact, as is claimed, that the receiver could make the sale to better advantage, is irrelevant, for the question is one of power and not of business judgment. The statutory requirements may not be disregarded through private agreements which affect others' rights without their consent.

In what circumstances, if at all, a statutory lien on personal property as a lien may be transferred to the proceeds of the sale of such property by agreement of all concerned need not be considered. Here we have a definite statutory provision based upon a well-understood reason limiting this lien to the actual possession of the property.

We think no argument is necessary or authorities required to support our conclusion that costs of administration come first in the distribution of proceeds derived from property which has been under the jurisdiction of the bankruptcy court.

The judgment is reversed, and the cause remanded for further proceedings in accordance with the views herein expressed.

[fol. 62] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 11669

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, etc., Appellant,

vs.

GEORGE T. GOGGIN, Trustee, etc., et al., Appellees

JUDGMENT—December 9, 1947

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

This cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court that the order and judgment of the said District Court in this cause be, and each of them hereby is reversed, and that this cause be, and hereby is remanded to the said District Court for further proceedings in accordance with the opinion of this court, with costs in this court in favor of the appellant, and against the appellees.

It is further ordered and adjudged by this Court that the appellant recover against the appellees for its costs herein expended, and have execution therefor.

[File endorsement omitted.]

[fol. 63] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 64] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 29, 1948

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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IN THE

Supreme Court of the United States

October Term, 1947
No. 667

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE, ETC.,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Appellees.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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IN THE

Supreme Court of the United States

October Term, 1947

No. .....

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE, ETC.,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Appellees.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, George T. Goggin (hereinafter referred to as trustee), as trustee in bankruptcy of the estate of Kessco Engineering Corporation, a corporation, prays that a writ of certiorari issue to review the final judgment of the United States Circuit Court of Appeals for the Ninth Circuit, said judgment determining that although the Collector of Internal Revenue, on behalf of the United States of America, had possession of personal property assets of the bankrupt prior to and at the time of the commencement of the within bankruptcy proceedings, nevertheless; the Collector lost the priority accorded to

him by Section 64(a) and Section 67(c) of the Bankruptcy Act, because he permitted the receiver in bankruptcy to take over said assets and to administer and sell the same; that in connection therewith the labor claims were entitled to priority of payment even though an agreement existed between the Collector and the receiver in bankruptcy that except for administrative expenses the lien of the Collector arising through possession would be transferred to the proceeds from the sale of the personal property. In effect the judgment of the Court below erroneously held that the Collector of Internal Revenue must maintain his actual possession of the personal property upon which he has made a seizure both before and after the commencement of the bankruptcy proceedings in order to retain his prior statutory lien pursuant to the provisions of Section 64 and Section 67(c) of the Bankruptcy Act.

Opinion Below.

The opinion of the Circuit Court of Appeal is not yet reported, but for the convenience of this Court the aforesaid opinion is set forth verbatim in the appendix. The judgment of the District Court merely affirmed the referee in bankruptcy, without an opinion.

Jurisdiction.

The judgment of the Circuit Court of Appeals for the Ninth Circuit was filed on December 9, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chapter 229, Section 1, 43 Stat. 938, 28 U. S. C. A., Sec. 437(a); and under Section 24(c) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 553, as amended by the Act of June 22, 1938, c. 575, Sec. 1, 52 Stat. 854; 11 U. S. C. A. Supp., Sec. 47(c).

Questions Presented.

1. If the Collector of Internal Revenue, on behalf of the United States of America, has recorded tax lien claims, and pursuant thereto has physically seized personal property of the bankrupt, prior to bankruptcy, does this actual possession give him a priority over labor claimants under the provisions of Section 67(c) of the Bankruptcy Act?

2. Assuming that the Collector was in actual possession of the personal property when bankruptcy commenced, does he lose his priority over labor claims by voluntarily surrendering his possession to the receiver in bankruptcy pursuant to an agreement that subject only to payment of expenses of administration the proceeds from the sale of the personal property would be first subject to the payment of the lien of the Collector?

Statutes Involved.

1. Section 64, Subdivision (a) of the Bankruptcy Act, as amended (United States Code, Title 11, Chap. 7, Sec. 104), reading as follows:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of

administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; PROVIDED, that no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; AND PROVIDED FURTHER, that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who, by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law; PROVIDED, HOWEVER, that such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy."

2. Section 67 on Liens and Fraudulent Transfers (United States Code, Title 11, Chap. 7, Sec. 107), particularly subdivisions (b) and (c) as follows:

"(b) The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

"(c) Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter X, XI, XII, or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act."

Statement.

The facts in the case at bar are undisputed.

The appellant below, respondent herein, accepted as the statement of facts the recitation contained in the certificate of the referee on petition for review in connection with the appeal by the said appellant to the District Court, and from this certificate we quote as follows [Record before Appellate Court, pp. 26-28]:

> "This proceeding began on March 26, 1946. On that date all of the assets, later liquidated by the trustee, were in the physical possession of the Collector of Internal Revenue. The Collector had previously made a seizure of the said assets pursuant to certain tax claims against the bankrupt, which tax claims are specifically described in Exhibit 'A' of your Referee's findings of fact, conclusions of law and order, a true copy of which is going up with this certificate. In addition to having made a physical seizure of the said assets, the Collector of Internal Revenue, prior to the commencement of this bankruptcy proceeding, had filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit 'A'. Pursuant to his legal rights and remedies, by virtue of the said seizure, the Collector of Internal Revenue had conducted a sale of the said assets and had received bids thereon, but the said sale was not completed because the price obtainable was unsatisfactory to the Collector. A second sale by the Collector was instituted but was abandoned when the said assets were relinquished to the receiver in this matter, as hereinafter set forth.
>
> On March 26, 1946, the day this proceeding began, George T. Goggin, now trustee, was appointed receiver in this matter. He qualified as such receiver on March 28, 1946. Upon his appointment and quali-

fication, the said receiver contacted the office of the Collector of Internal Revenue and conversations were had between the receiver and counsel in the Los Angeles office of the Collector relating to the turning over of the said assets by the Collector to the receiver. Thereafter, the following telegram was received by the Los Angeles office of the Collector of Internal Revenue from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue:

> 'Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale.
>
> J. P. WENCHEL
> Chief Counsel.'

The contents of the said telegram were imparted by telephone to the office of the said receiver. No formal acceptance or acknowledgment thereof was made by the receiver. No notice of the telegram or of its contents was given to any of the creditors or other parties in interest in this matter and no notice thereof was given at the time of the trustee's sale of the aforesaid assets. After the said telegram had been imparted to the office of the said receiver, as aforesaid, the said receiver, with full knowledge of the said telegram and of its contents and without any objection thereto, took over the possession of the said assets from the Collector of Internal Revenue. Later the said receiver, in his capacity as trustee, caused the said assets to be sold at public auction, pursuant to the order of this Court."

On October 17, 1946, the petitioner herein filed a petition for order to show cause re: Tax & Labor Claimants, dated October 4, 1946, and, pursuant to this petition, an order to show cause was duly issued by the Referee in Bankruptcy on October 18, 1946, directing the various tax and labor claimants to show cause why the said referee should not determine the priority and method of payment of the expenses of administration, tax claimants, and prior labor claimants. Hearing was duly had thereon upon the 30th day of October, 1946; thereafter, the Referee duly signed findings of fact, conclusions of law and an order, finding as follows:

1. That from the monies in the possession of George T. Goggin, as trustee, there shall first be paid the expenses of administration.

2. That after the payment of the expenses of administration, the balance of the funds then in the hands of the trustee should be paid to the Collector of Internal Revenue in partial payment of the tax claim for which he had filed and recorded a lien and had seized actual possession of personal property involved, prior to the commencement of the bankruptcy proceeding; the amount of said lien and seizure claims being more than the total of the funds in the hands of the trustee arising from the sale of the physical assets.

The respondent herein, the Division of Labor Law Enforcement for the State of California, filed a petition for review from the order of the referee and the matter was duly heard before the District Judge below, and the Honorable Campbell E. Beaumont, as said District Judge, duly made and entered an order, on May 21, 1947, confirming the order of the referee above referred to entered on De-

cember 12, 1946, and adopting the findings of fact and conclusions of law of the referee.

From the order of the District Judge the Division of Labor Law Enforcement for the State of California duly filed a notice of appeal and the matter was presented to the United States Circuit Court of Appeals for the Ninth Circuit and finally determined on December 9, 1947, by an opinion filed on that date. This opinion reversed the order of the referee and the District Judge and directed the referee to allow the labor claims represented by the Division of Labor Law Enforcement for the State of California as prior claims to be paid before paying any monies to the Collector of Internal Revenue on behalf of the United States of America, and petitioner now seeks review by certiorari.

Reasons for Granting the Writ.

1. This cause involves questions of far-reaching importance in the practical administration of bankruptcy problems, throughout the nation, necessitating an authoritative determination by this Court; the effect of the erroneous decision by the Ninth Circuit would be to compel the Collector of Internal Revenue to refuse to surrender possession of any physical property once he had seized the same prior to the commencement of bankruptcy proceedings and since bankruptcy courts and supervised sales have proven to be more advantageous to creditors than sales through the Collector of Internal Revenue, the result will be detrimental to the possibility of labor and unsecured creditor claimants recovering a fair dividend in any such case.

2. The decision of the Circuit Court of Appeal conflicts with a fundamental bankruptcy rule enunciated in many cases by this Court that the rights of all creditors, and their priorities, are determined as of the time that the bankruptcy proceedings are commenced.

Myers v. Matley (1943), 318 U. S. 622, 626;

U. S. v. Marxen (1939), 307 U. S. 200, 207-8;

White v. Stump (1924), 266 U. S. 310, 313;

Bailey v. Baker Ice Machine Co. (1915), 239 U. S. 268, 275;

Everett v. Judson (1913), 228 U. S. 474, 479;

Acme Harvester Co. v. Beekman Lumber Co. (1911), 222 U. S. 300, 307.

3. The decision of the Circuit Court of Appeals conflicts with the Bankruptcy Act, which provides that the statutory liens of the Collector of Internal Revenue, on behalf of the United States of America, on personal property accompanied by possession of said property is completely unaffected by Section 67(c) of the Bankruptcy Act and are prior in time of payment to wage claims.

4. The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court logically holding that receivers and trustees in bankruptcy may take over the physical possession of personal property held by a person under a claim of lien, and may sell such personal property, pursuant to the order of the referee, free of the lien claim; that such lien claim may then be transferred to the proceeds from the sale without disturbing the right of the claimant as it existed at the time that the bankruptcy proceeding commenced.

Van Huffel v. Harkelrode (1931), 284 U. S. 225.

5. The decision of the Circuit Court of Appeals for the Ninth Circuit is directly in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit, in petition of *International Harvester Co. of America* (C. C. A. 6th 1925), 9 F. (2d) 299, wherein the court finds that in the absence of any circumstances indicative of an express waiver of a lien claim, no waiver of a right of lien should be implied from the mere surrender of possession by a claimant to a receiver. The "measure stick" set up by the Sixth Circuit is entirely equitable, logical and in accordance with good business sense.

Conclusion.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted to review the judgment of the Circuit Court of Appeals for the Ninth Circuit.

Dated: March 1, 1948.

GEORGE T. GOGGIN, AS TRUSTEE,
Petitioner,

By MARTIN GENDEL,
Counsel for Petitioner.

GENDEL & CHICHESTER,
Of Counsel.

IN THE

Supreme Court of the United States

October Term, 1947

No. .....

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE, ETC.,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Appellee.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

May It Please the Court:

Opinions Below.

The opinion of the Circuit Court of Appeals is not yet reported, but it set forth verbatim in the appendix attached to the within petition and brief. The opinion of the District Court merely adopted and confirmed the findings of fact, conclusions of law and order of the referee.

Jurisdiction.

The grounds upon which the jurisdiction of this court is invoked are stated in the petition at page 2.

Statement of the Case.

The facts appear in the petition at pages 6 to 9, and in the interest of brevity are not repeated herein.

Specifications of Error.

THE CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT ERRED:

1. In failing to recognize that the Collector of Internal Revenue, on behalf of the United States of America, by recording statutory tax liens and pursuant thereto having actual possession of personal property through seizure, at the time that the bankruptcy proceedings commenced, was then entitled to a priority over any labor claims; that this priority became fixed and frozen as of the commencement of the bankruptcy proceeding; that the subsequent surrender, by consent of the Collector of Internal Revenue, of custody of the personal property to the receiver in bankruptcy on condition that only the expenses of administration should be deducted from the proceeds of the sale of the personal property until the tax lien claims were paid in full, did not constitute a loss of the priority theretofore held by the Collector, and the provisions of Section 67(c) of the Bankruptcy Act could not be invoked by labor claimants in order to obtain any priority over the Collector as to the proceeds from the sale of the assets originally seized by him.

Summary of Argument.

1. The Collector of Internal Revenue, on behalf of the United States of America, having recorded statutory tax lien claims and pursuant thereto having physically seized personal property of the bankrupt prior to bankruptcy, thereby obtained actual possession of the personal property which entitled the Collector to a priority over labor claimants pursuant to the Bankruptcy Act and particularly Section 64(a) and Section 67(c) thereof.

2. The Circuit Court of Appeals failed to recognize a cardinal principle of Bankruptcy Law providing that the time when the bankruptcy petition is filed is the date of cleavage governing the rights of creditors to priority under Section 64(a) and Section 67(c) of the Bankruptcy Act.

3. Since the Collector was in actual possession of the personal property when bankruptcy commenced, he did not lose his priority over labor claims by voluntarily surrendering custody to the receiver in bankruptcy, because this surrender was pursuant to an agreement that subject only to payment of expense of administration, the proceeds from the sale of the personal property would be first subject to payment of the lien of the Collector.

4. The authorities cited by the respondent herein, *as appellant* before the Circuit Court of Appeals, do not support the opinion of the Circuit Court of Appeals and the one case cited by the Circuit Court of Appeals does not support its conclusion.

ARGUMENT.

1. The Collector of Internal Revenue, on Behalf of the United States of America, Having Recorded Statutory Tax Lien Claims and Pursuant Thereto Having Physically Seized Personal Property of the Bankrupt Prior to Bankruptcy, Thereby Obtained Actual Possession of the Personal Property Which Entitled the Collector to a Priority Over Labor Claimants Pursuant to the Bankruptcy Act and Paricularly Section 64(a) and Section 67(c) Thereof.

(a) Subdivision "c" of Section 67 of the Bankruptcy Act, as amended in 1938, expressly provides that labor claims as set forth in clause 2 of subdivision "a" of Section 64 of the Bankruptcy Act shall be subordinated to statutory liens for taxes owing to the United States providing that such liens on personal property are accompanied by possession.

(b) In Volume 4 of Colliers on Bankruptcy (14th Ed. 1942), we find the following undisputed statements of law:

Page 164:

> ". . . 3. Statutory liens . . . on personal property accompanied by possession of such property are completely unaffected by Section 67(c)."

Page 236 of the same volume:

> ". . . On the other hand the principle of subordination introduced by §67(c) does not apply in the case of the following liens: . . . (c) All statutory liens . . . on personal property accompanied by possession of such property."

and see,

In re Pennsylvania Central Brewing Co. (C. C. A. 3, 1940), 114 F. (2d) 1010, certiorari denied, 312 U. S. 685.

2. The Circuit Court of Appeals Failed to Recognize a Cardinal Principle of Bankruptcy Law Providing That the Time When the Bankruptcy Petition Is Filed Is the Date of Cleavage Governing the Rights of Creditors to Priority Under Section 64(a) and Section 67(c) Thereof.

(a) ". . . the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. . . . The transfer of the assets to someone for application to 'the debts of the insolvent, as the rights and priorities may be made to appear', takes place as of that time."

Quoted from

United States v. Marxen (1939), 307 U. S. 200, at pp. 207-208;

Myers v. Matley (1943), 318 U. S. 622, 626;

White v. Stump (1924), 266 U. S. 310, 313;

Bailey v. Baker Ice Machine Co. (1915), 239 U. S. 268, 275;

Everett v. Judson (1913), 228 U. S. 474, 479;

Acme Harvester Co. v. Beekman Lumber Co., (1911), 222 U. S. 300, 307.

(b) This general rule of law is reiterated in Collier's work on bankruptcy in many subdivisions thereof, particularly as follows:

In volume 4 at page 228 we find:

"The general rule in bankruptcy is that the filing of the petition freezes the rights of all parties interested in the bankrupt estate. . . ."

In volume 3 at page 2059, we find the same language paraphrased as follows:

> ". . . With regard to those claims accruing against the bankrupt prior to bankruptcy, the time when the petition is filed is the date of cleavage—that is, the date on which the right to priority under §64 must be determined. . . ."

3. Since the Collector Was in Actual Possession of the Personal Property When Bankruptcy Commenced, He Did Not Lose His Priority Over Labor Claims by Voluntarily Surrendering Custody to the Receiver in Bankruptcy, Because This Surrender Was Pursuant to an Agreement That Subject Only to Payment of Expense of Administration, the Proceeds From the Sale of the Personal Property Would Be First Subject to Payment of the Lien of the Collector.

(a) Personal property in the possession of a receiver and trustee in bankruptcy may be sold free from liens and encumbrances, and the liens will then be transferred to the proceeds. In the language of Volume 6, Remington, Bankruptcy Law (4th Ed. 1937), page 71, we contend as follows:

> ". . . And the right to sell property in the Bankruptcy Court clear and free from all incumbrances, and to transfer the lien to the proceeds, is now beyond dispute."[1]

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[1] 6 Remington, Bankrupty Law (4th Ed. 1937), p. 71:

"§2577. Selling Free From Liens and Transferring Liens to Proceeds.—The property may be sold free from liens and incumbrances, and the liens be transferred to the proceeds.

"No form was prescribed for this purpose by the Supreme Court, and no special authorization of sales free from liens is to be found

and again in Remington, Bankruptcy Law (4th Ed. 1937), in Volume 6, page 77, we find a restatement of the law heretofore quoted, in the following language:

> "§2578. Lienholder's Consent to Sale Free of Liens.—And it does not require the lienholder's consent, even where the referee orders the sale.
>
> "It is clear that, by agreement, property also may be sold clear and free and the liens transferred to the fund; and the agreement may be implied."

and, at page 78 of Volume 6, Remington cites 18 cases in support of the following statement of the law:

> "§2579. Selling Clear and Free before Validity or Priority of Liens Determined.—A sale free and clear from liens may be ordered before the validity

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in the statute itself; but, so far as statutory authorization is concerned, nothing is found in the statute specifically authorizing sales subject to liens, nor at private sales, nor of perishable property, and yet those methods of sale are deemed proper in bankruptcy. And it would be a serious defect were it not permissible to sell property in bankruptcy free from liens, because such is ordinarily the best method of selling property. To sell property free and clear from all liens, and to have all controversies relative to the validity and extent of liens thereon transferred to the fund, is likely to lead to better prices. Otherwise the purchaser would have to buy all the controversies along with the purchase of the property itself. And the right to sell property in the bankruptcy court clear and free from all incumbrances, and to transfer the liens to the proceeds, is now beyond dispute."

P. 75: "And it may be sold free, even from the lien of taxes."

P. 76: ". . . The provisions of the Bankruptcy Act that valid liens shall not be affected by bankruptcy proceedings has reference only to the validity of the contract, and not to the remedy nor forum for enforcing the lienholder's rights, which may be changed without impairing the contractual obligation, providing an equally adequate and efficient remedy is substituted."

". . . And the transferring of the liens to the proceeds of the sale is an incidental power of the Court."

and priority of the liens have been determined, the controversies being transferred to the funds."

And see:

Van Huffel v. Harkelrode (1931), 284 U. S. 225;

Coulter v. Blieden (C. C. A. 8th 1939), 104 F. (2d) 29, certiorari denied 308 U. S. 583.

(b) The petitioner herein, as receiver, accepted surrender of custody of the personal property in question under the express terms specified by the Collector to the effect that only expenses of administration would be allowed out of the proceeds from the sale of the assets, and that otherwise the lien would prevail until the taxes in question were paid in full; the Circuit Court of Appeals erred in failing to recognize that the tacit acceptance of the conditions imposed by the Collector maintained, in legal effect, the actual possession of the Collector which was his at the time that the bankruptcy proceedings commenced.[2]

(c) The conduct of the Collector of Internal Revenue, on behalf of the United States of America, and of your petitioner, as receiver, eliminates any possible contention that the Collector intended to waive his priority rights obtained by having made a physical seizure prior to bankruptcy.

(1) See subdivision "b" *supra* as to the terms specified by the Collector.

(2) Not only the law, but good logic, fair dealing, and practical business reasons require that the Bankruptcy Court should be permitted to sell the assets

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[2]See pages 6 to 9 of the Petition for Writ of Certiorari.

involved in a dispute and to transfer the dispute to the proceeds from the sale, without changing the rights of the parties, particularly where there are no grounds from which a waiver can be implied. We again respectfully call the attention of this court to the case of *International Harvester Co. of America* (C. C. A. 6, 1925), 9 F. (2d) 299, particularly at page 300, wherein the Court states the rule of law as follows:

> ". . . In the absence of any circumstances indicative of a waiver of the lien claim, such a waiver of a right should not be implied in fact from the mere surrender of possession to a receiver. . . . ."[3]

---

[3]With apologies to this Honorable Court for quoting at length from the *International Harvester Company* case, we do feel that the language of the case is important to the proper presentation of our petition, and we quote therefrom at page 300:

> "It is, however, contended that petitioner is entitled to a lien because, pursuant to the mortgage, it had taken and was in possession of the chattels at the time of the adjudication in this voluntary bankruptcy proceeding. The referee, however, found that the petitioner had waived the possession so taken; that the received in bankruptcy had then acquired possession and had sold the goods as the bankrupt's property.
>
> Clearly there was a waiver of actual possession. The receiver did not take possession forcibly or without consent; but this possession, acquired after bankruptcy, does not necessarily involved a waiver of any right which by actual seizure petitioner may have acquired and may have had at the time of the filing of the petition in bankruptcy to retain the possession. Whether or not that right to possession and the lien, if any, thereby acquired, were waived, depends upon the agreement under which actual possession was surrendered and a sale by the receiver permitted. It is quite common expressly to agree that the bankruptcy court may determine the validity of a lien, and that such lien shall attach to the proceeds. One in possession may, however, expressly waive any claim of lien

The Circuit Court of Appeals for the Ninth Circuit has ruled directly contrary to the salutary rule of law as laid down by the Sixth Circuit, *supra*. We respectfully contend that this situation alone should justify the consideration and granting of the within petition for certiorari and the enunciation by this Court of a binding rule of law which will eliminate any confusion between Circuits.

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and be content to rank as a general creditor. The parties may fail to express their understanding in words. The court must then find it from the circumstances. In the absence of any circumstances indicative of a waiver of the lien claim, such a waiver of a right should not be implied in fact from the mere surrender of possession to a receiver. The desire to avoid controversy with the court's representative, the general willingness, especially of laymen, to submit to the bankruptcy court the determination of questions which, without such submission, might be, though laymen may not know them to be, beyond its compulsory jurisdiction, suffices to explain a transfer of possession without waiver of lien; indeed, in the belief that the claim to a lien would necessarily be adjudicated in the bankruptcy proceedings. The claim for priority, as filed, states that possession had been taken by petition and a sale advertised, but that this sale had been restrained by the bankruptcy court. In the objections filed by the trustee, no waiver, either of possession or of the right of possession, is alleged. In view of the informal nature of pleadings in such causes, this suffices, in our judgment, to compel a determination of petitioner's right to a lien because of its possession, and notwithstanding the subsequent surrender of actual possession. The trustee should be given opportunity to amend his objections, so as clearly to present the essential issues, especially as his counsel may have been led to believe by the colloquy at the end of the hearing, set forth in the footnote, that petitioner relied solely upon the filing of the mortgage.

Therefore, notwithstanding our concurrence in the construction of the statute, the petition to revise is granted, and the cause remanded, to permit the parties to amend the pleadings, and thereupon to determine whether or not, in the circumstances, petitioner obtained a valid lien by virtue of its possession prior to and at the time of filing the petition in bankruptcy (See *Peter Schuttler Co. v. Gunther*, 222 Mich. 430, 192 N. W. 661, 49 Am. Bankr. Rep. 678), and, if so, whether or not it waived this lien by reason of the surrender of the actual possession to the receiver."

4. The Authorities Cited by the Respondent Herein, as Appellant Before the Circuit Court of Appeals, Do Not Support the Opinion of the Circuit Court of Appeals and the One Case Cited by the Circuit Court of Appeals Does Not Support Its Conclusion.

(For the sake of brevity we shall attempt to merely summarize our objections to all the authorities used by the respondent in arguing the case before the Circuit Court of Appeals and the sole case cited by the Circuit Court of Appeals in its opinion.)

(a) The one case cited by the Circuit Court of Appeals, in its entire opinion, *City of New York v. Hall* (C. C. A. 2d 1944), 139 F. (2d) 935, does not sustain the opinion of the Circuit Court and is actually authority in direct support of the position now being urged by your petitioner. [See Appendix p. 34.] The Ninth Circuit points out that "possession" as used in Section 67(c) means actual possession, and states that the purpose of such possession is to protect and give warning to creditors. This reasoning is apropos only as to matters occurring prior to the commencement of the bankruptcy proceedings. For, once the bankruptcy proceedings are commenced, creditors cannot change such rights as existed at the time that the petition was filed. Therefore, simple logic indicates that the possession required in order to warn creditors need not continue once the bankruptcy has commenced—*custodio legis intervenes*. The *Hall* case emphasizes the apparent failure of the Ninth Circuit to properly analyze the facts before it in the instant case. In the *Hall* case the City of New York issued its warrant and docketed claims for city taxes at 1:45 p. m.; at 4:22 p. m. of the same day an involuntary petition in bankruptcy was filed, and not until

4:30 p. m. were the physical assets seized by the city of New York. Therefore, when the receiver sold the property, since the city did not have possession at the time that the bankruptcy commenced, Section 67(c) required a ruling contrary to the claims of lien by the city. In the language of the case itself, page 936, we urge the inapplicability of the *Hall* case to sustain the opinion of the Circuit Court of Appeals:

> "... *for obviously there was not actual possession by the City at the time of the filing of the bankruptcy proceeding.*" (Italics ours.)

That the contention of your petitioner is correct is demonstrated by a reading of the case of *Davis v. City of New York* (C. C. A. 2d 1941), 119 F. (2d) 559, wherein the same tax claimant was upheld for a similar tax where possession was obtained by physical seizure of the personal property on May 16, 1939, and the involuntary bankruptcy was not filed until June 7, 1939.

(b) Not one of the cases cited by the Division of Labor as authorities in support of its argument before the Circuit Court of Appeals, sustains the opinion of the Circuit Court of Appeals any more than does the case of the *City of New York v. Hall, supra,* relied upon by the said Circuit Court. For the sake of convenience, we shall consider all of these cases in the order in which they are presented in the opening and reply brief of the Division of Labor before the Circuit Court.

At page 12 of the opening brief, the Division of Labor cites *In re Auto Repair and Parts Co.*, 41 F. Supp. 3, and *In re Pennsylvania Central Brewing Co.*, 114 F. (2d) 1010. However, the inapplicability of these cases is ad-

mitted by the appellant, at page 12 of its brief, in the following language:

> "The question of possession was not, however, involved in the above cases."

If the case does not involve the issue of possession, we cannot see how it can possibly be used as authority in the instant case on review.

On page 13, *Stratton v. New* (1931), 283 U. S. 318, is cited in support of the contention that the trustee could have appeared in the tax sale proceeding and seized for the bankruptcy estate any balance that might be remaining if the Collector had retained possession of the physical assets involved and had sold the same under his claim of lien. Neither the law nor good business administration requires the following of this practice, and the mere conferring of jurisdiction on the bankruptcy court by stipulating to a transfer of custody without a waiver of lien rights does not defeat priorities in existence at the time of the commencement of the bankruptcy proceedings.[4]

At page 14 of the opening brief of the Division of Labor, the case of *In re San Joaquin Valley and Packing Co.*, 295 Fed. 311, is cited to support a statement of law with which we have no quarrel, and that is that the

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[4]In the matter of *In re Knox-Powell-Stockton Co., Inc.* (C. C. A. 9, 1939), 100 F. (2d) 979, even the Ninth Circuit Court of Appeals recognizes the alternative procedure which we argue is open to creditors and receivers and trustees, in the following language, page 932:

> "This section makes it clear that adjudication in bankruptcy does not interfere with existing valid liens, and that the trustee takes the property of the bankrupt subject to all such liens as would have been enforceable against it in the hands of the bankrupt himself. *Riscook v. Varick Bank*, 206 U. S. 28. . . ."

trustee in bankruptcy is not an agent for the Collector of Internal Revenue, but, as an officer of the Court, represents all creditors. This is undisputed, and, as an officer of the Court, the trustee is required to urge the correct application of the law to the facts, as far as a proper distribution of the assets is concerned, even in the case of one creditor against another.[5]

Also at page 14, the *City of New York v. Hall, supra,* is cited and we believe that we have considered this case sufficiently in subdivision "a" of this portion of the argument. Obviously, the issue of constructive possession is not involved in the instant case for the reason it is stipulated that the Collector had actual possession when the bankruptcy proceedings commenced.

On pages 14 and 15 of the opening brief of the Division of Labor there is cited the case of *In re Jay & Dee Storage Co.*, 37 Fed. Supp. 989. This case does not assist in supporting the opinion of the Circuit Court of Appeals because it does not involve any facts concerning the issue of possession; likewise, it is an opinion involving a claim for rent, rather than taxes, and such a claim is

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[5]"A trustee in bankruptcy is the representative of the creditors."
2 Collier's on Bankruptcy (14th Ed.) 1737;
Eyster v. Gaff, 91 U. S. 521.

The following quotation is from the case of *Atkins v. Wilcox* (C. C. A. 5), 5 A. B. R. 313, 316, 105 Fed. 595:

> "By the clearest implication he (the trustee) represents all the creditors, and as such representative has an interest in the just administration of the estate which belongs to the creditors."

treated differently than a statutory lien for taxes accompanied by actual possession. (See 67(c) of the Bankruptcy Act.)

We have no quarrel with the law stated on page 15 of the opening brief, in the case of *In re Jackson Brick & Tile Co.*, 189 Fed. 686, to the effect that the referee has jurisdiction to determine the validity of a lien.

At page 15, and for several pages thereafter, in the opening brief, the Division of Labor places great reliance upon the case of *In re Lebed*, 39 Fed. Supp. 457. There is no similarity between the facts in the *Lebed* case and the instant case. In the *Lebed* case a landlord's lien for rent is the issue involved, and under Section 67(c) such a lien cannot have priority over the labor claimants even if accompanied by possession. Secondly, the agreement in question in the instant case was entered into after the commencement of the bankruptcy proceedings, *i. e.* after the lien rights of the Collector were frozen, and was not a prebankruptcy agreement as existed in the *Lebed* case.

The last case cited in the opening brief of the Division of Labor is *Freeman Furniture Factories Company, Inc. v. Bowlds*, 136 F. (2d) 136. We have no quarrel with the law stated in the *Freeman* case to the effect that costs of administration are properly chargeable to a fund arising from the sale by the bankruptcy court of certain assets. We make the same contention in the instant case even in the absence of any stipulation to this effect by the Col-

lector of Internal Revenue.* The *Freeman* case states the law as was ably applied by the Referee, in the instant case, and justifies the payment of administration expenses first, then the allowance of the statutory lien claim as accompanied by actual possession. The *Freeman* case cannot be distorted into a ruling in any way supporting the contention that labor claims, as well as expenses of administration, must be allowed prior to the tax lien claims involved in the instant case.

The only new authorities cited by the Division of Labor in its reply brief are contained on pages 3 and 4 in support of a contention that the Receiver in Bankruptcy could not enter into the agreement with the Collector of Internal Revenue whereby the lien would continue on the assets in the hands of the receiver. The cases cited are *In re Kolin,* 134 Fed. 557, and *In re Cox Baking Co.,* 77 F. (2d) 294. Merely reading the quotation from the opinion given by the brief of the Division of Labor indicates the fact that the cases do not at all sustain the statement of the law for which they are cited, and it is basic Hornbook Law that a receiver is an officer of the Court; as such he can enter into binding agreements whereby liens existing at the time of the commencement in bankruptcy shall follow the proceeds from the sale of the physical assets involved in such lien. (See authorities cited under Argument No. 3, *supra.*) When bankruptcy intervenes the legal effect of possession continues, the claimant has merely surrendered custody to the receiver.

*See telegram to Collector, petition for writ of certiorari, p. 7.

Conclusion.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is not only contrary to the law and to the facts involved, but likewise has hampered, and unless reversed, will continue to hamper the orderly and proper administration of bankruptcy proceedings. This is particularly so because the Collector of Internal Revenue is now placed in the position of attempting to hazard a guess as to whether or not a Court will enforce the broad implications of the opinion of the Circuit Court of Appeals and thereby requires the Collector to hold on to all personal property on which he is claiming a statutory lien by virtue of actual possession, and to refuse to surrender such possession to the more orderly and profitable administration of the Bankruptcy Court.

Wherefore, it is respectfully submitted that this petition for Writ of Certiorari should be granted, and that this Honorable Court review the decision of the United States Circuit Court of Appeals for the Ninth Circuit and reverse it.

Dated: March 1, 1948.

Respectfully submitted,

MARTIN GENDEL,
Counsel for Petitioner.

GENDEL & CHICHESTER,
Of Counsel.

APPENDIX.

Opinion of the United States Circuit Court of Appeals.

In the United States Circuit Court of Appeals for the Ninth Circuit.

Division of Labor Law Enforcement, State of California, statutory assignee, etc., Appellant, vs. George T. Goggin, Trustee in Bankruptcy of the Estate of Kesseo Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Sixth Collection District of California, Appellees. No. 11,669. Dec. 9, 1947.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Before: Mathews, Stephens and Orr, Circuit Judges.

Stephens, Circuit Judge.

The Kesseo Engineering Corporation, a California corporation, brought a voluntary petition in bankruptcy, and orders of adjudication and general reference were made on March 26, 1946. At that time the Collector of Internal Revenue had physical possession of the assets of said bankrupt pursuant to certain tax claims, notices of such liens having been filed. The property was put up for sale, but the sale was never completed because the price obtainable was unsatisfactory. The collector then relinquished the assets to the receiver in bankruptcy under an alleged agreement made by and between an official of the Bureau of Internal Revenue and the said receiver, George T. Goggin, in the following circumstances. The Los Angeles office of the collector was contacted in regard to the assets and their sales value by Goggin. A telegram was thereafter sent by the Bureau to

the Los Angeles office as follows: "Reference to telephone conversation today with Mr. Webb [member of the Los Angeles office of Internal Revenue] relative to Kessco Engineering Corporation, bankrupt; no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale." The information as to these transactions were received, but no formal acceptance or acquiescence by the receiver was ever made. No notice thereof was given to the creditors or other parties in interest, nor was any notice of an intended trustee's sale ever given them. The receiver, with knowledge of the telegram, took physical possession of the assets from the collector and later in the capacity as trustee caused the assets to be sold at public auction. What notice, if any, was given does not appear in the record. Prior wage claimants filed their wage claims against the assets through the Division of Labor Law Enforcement of California. The referee put the government's claim ahead of the wage claims to the same extent as though the lien on the property followed the proceeds of its sale. The district court confirmed, and the labor claimants appeal through the California Division of Labor.

The appellant takes the position that by surrendering possession of the assets to the receiver, the collector lost the superior position which he had theretofore enjoyed. It is contended that the collector, not having enforced his lien by sale, subjected himself and his claim to the provisions of Section 67(c) of the Bankruptcy Act [11 U.S.C.A. § 107c (1946)] when he appeared in the proceedings and voluntarily surrendered possession of personal property to the trustee, and that the alleged

agreement heretofore detailed has no legal binding effect on statutory rights of prior wage claimants. It is also urged that, since the referee directed payment of expenses of administration prior to payment of the collector's lien, Section 67(c) of the Act makes it obligatory to also pay the labor claims before payment of the government's claim.

The referee's order and judgment in the district court upheld the superiority of the lien and approved the action on the agreement.

The appellees, in support of the judgment, urge that the agreement or conditions attached by the government to the release and sale of the personal property protected them against loss of superior position. The determination of this question rests upon the construction of Section 67(c) of the Bankruptcy Act, which provides as follows: "Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by *possession* [emphasis ours] of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment of the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payments to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act." Section 64a of the Act [11 U.S.C.A. § 104a (1946)] provides, respectively, for priority of expenses of administration and for wages of

a restricted amount earned within a given time before bankruptcy proceedings to be paid in advance of payment of dividends to creditors.

At the time the proceedings began, the collector had possession of the assets, but he subsequently relinquished them to the receiver and trustee in the already mentioned circumstances. Did the lien follow and attach to the sale proceeds?

The appellants contend that possession under the statute means *actual* possession prior to and subsequent to the filing of the petition in bankruptcy, whereas appellees contend that actual possession, which was enjoyed at the time the action in bankruptcy was commenced, need not be retained in order to protect priority in payment.

We agree with the Second Circuit in City of New York v. Hall, 139 Fed. (2d) 935, in the holding that "possession" as used in Section 67(c) means actual possession, the purpose being to protect and give warning to creditors. In the instant case the government had actual possession, but it surrendered that possession by virtue of a bargain with the receiver without taking into account the wage and creditor claimants. The Act provides that wage claims come ahead of the government lien in distribution of the proceeds of sale of property not in possession of the government lien holder. The government lien holder must either sell the property under its lien or eventually surrender it into the bankruptcy proceedings. We find no authority whatever for the proposition that the government can turn the property over to the trustee under a consent based upon the receiver's assurance that the lien shall continue upon the property and also upon the money it may bring when sold as a part of the bankruptcy estate. It is our opinion that the wage

claimants had certain statutory rights at the inception of the bankruptcy proceedings, and such rights remained throughout the proceedings, modified by the actual possession of the assets. The fact, as is claimed, that the receiver could make the sale to better advantage, is irrelevant, for the question is one of power and not of business judgment. The statutory requirements may not be disregarded through private agreements which affect others' rights without their consent.

In what circumstances, if at all, statutory lien on personal property as a lien may be transferred to the proceeds of the sale of such property by agreement of all concerned need not be considered. Here we have a definite statutory provision based upon a well-understood reason limiting this lien to the actual possession of the property.

We think no argument is necessary or authorities required to support our conclusion that costs of administration come first in the distribution of proceeds derived from property which has been under the jurisdiction of the bankruptcy court.

The judgment is reversed, and the cause remanded for further proceedings in accordance with the views herein expressed.

(Endorsed): Opinion. Filed Dec. 9, 1947. Paul P. O'Brien, Clerk.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. 35

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Petitioner,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, Statutory Assignee, etc.,

Respondent.

RESPONDENT'S OPPOSING BRIEF.

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IN THE

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Petitioner,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, Statutory Assignee, etc.,

Respondent.

RESPONDENT'S OPPOSING BRIEF.

Petitioner seeks a review by this Honorable Court of a final judgment of the United States Circuit Court of Appeals for the Ninth Circuit. The judgment holds that by voluntarily relinquishing possession to the Receiver in Bankruptcy personal property on which there was a tax lien, the Collector of Internal Revenue, although retaining his lien claim, subrogated the lien to payment of prior wage claims by virtue of the specific provisions of Section 67(c) of the Bankruptcy Act; that a bargain between the Collector of Internal Revenue and the Receiver in Bank-

ruptcy providing that the lien would apply to the property and proceeds from the lien sale after relinquishment of possession, could not set aside statutory rights of the prior wage claimants.

Opinion Below.

The opinion of the Circuit Court of Appeals, set forth in full in the appendix of Petitioner's Brief, is reported at 165 F. (2d) 155.

Statement of Case.

The facts set forth in Petitioner's Petition, pages 6 to 9 inclusive, are accurately stated and for purposes of brevity are not here repeated.

Statutes Involved.

The statutes involved: Section 64, Subdivision (a) of the Bankruptcy Act (United States Code, Title 11, Chap. 7, Sec. 104); and Section 67, Subdivision (c) of the Bankruptcy Act (United States Code, Title 11, Chap. 7, Sec. 107); are set forth in Petitioner's Petition, pages 3 to 5 inclusive, and for purposes of brevity are not here repeated.

Question Presented.

Does the decision rendered herein by the United States Circuit Court of Appeals for the Ninth Circuit conflict with applicable decisions of the Supreme Court of the United States, conflict with the Bankruptcy Act or conflict with decisions rendered in other Circuits of the United States Circuit Court of Appeals?

Argument.

The decision of the United States Circuit Court of Appeals is not in conflict with:

A. Applicable decisions of the Supreme Court of the United States.

B. The decisions rendered in other Circuits of the United States Circuit Court of Appeals.

C. The Bankruptcy Act.

A. On page 10 of Petitioner's Petition six cases decided by this Court are cited. These cases enunciate the established bankruptcy rule that rights of all creditors and their priorities are determined at the time bankruptcy proceedings are instituted.

Myers v. Matley (1943), 318 U. S. 622;

U. S. v. Marxen (1939), 307 U. S. 200;

White v. Stump (1924), 266 U. S. 310;

Bailey v. Baker Ice Machine Co. (1915), 239 U. S. 268;

Everett v. Judson (1913), 228 U. S. 474;

Acme Harvester Co. v. Beekman Lumber Co. (1911), 222 U. S. 300.

This rule is not an issue in the instant case for the rule concerns itself with the rights and status of creditors of the bankrupt as against the trustee in bankruptcy and has nothing to do with the question of priority in payments as between creditors from the assets of the bankrupt's estate.

In *Bailey v. Baker Ice Machine Co.*, *supra*, it is said:

"When not otherwise specially provided, the rights, remedies, and powers of the trustee are determined

with reference to the conditions existing when the petition is filed. It is then that the bankruptcy proceeding is initiated, that the hands of the bankrupt and of his creditors are stayed, and that his estate passes actually or potentially into the control of the bankruptcy court. We have said: 'The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate.'"

There is no conflict with that rule; respondent has never sought, nor has the court below granted, any enlargement of the prior labor claims. The prior wage claims were definitely and irrevocably fixed in amount as a liability of the estate of the bankrupt under the provisions of Section 64, Subdivision (a) of the Bankruptcy Act; they were correctly calculated as being amounts due for wages earned and unpaid during the three months' period immediately prior to the filing of the period in bankruptcy, not in excess of $600.00 each.

The decision of the United States Circuit Court of Appeals for the Ninth Circuit interpreting a section of the Bankruptcy Act concerning priority payments of established prior wage claims over established lien claims on personal property does not violate the rule of this Court set forth above, or any other rule or interpretation of law enunciated by this Court.

B. On page 10 of Petitioner's Petition it is stated that the decision of the Circuit Court of Appeals for the Ninth Circuit is in conflict with the decision rendered in the Sixth Circuit in the petition of *International Harvester Co. of America* (C. C. A. 6th), 9 F. (2d) 299. There is no such conflict and the cases are clearly distinguishable.

In the *International Harvester* case the issue was whether the chattel mortgagee had possession prior to and at the time of bankruptcy, since the existence of the lien depended on possession. In the instant case existence of the lien does not depend on possession, and it has never been contended by Respondent that the lien fell following surrender of possession by the Collector of Internal Revenue to the Receiver. Respondent urged below that surrender of possession merely withdrew from the lien claim its suprior position over prior wage claims. The Court below upheld this contention, stating:

> "In the instant case the government had actual possession, but it surrendered that possession by virtue of a bargain with the receiver without taking into account the wage and creditor claimants. The Act provides that wage claims come ahead of the government lien in distribution of the proceeds of sale of property not in possession of the government lien holder."

Further, the general question of surrender of possession was not decided in the *International Harvester* case. The Court states:

> "Therefore, notwithstanding our concurrence in the construction of the statute the petition to revise is granted, and the cause remanded, to permit the parties to amend the pleadings, and thereupon to determine whether or not, in the circumstances, petitioner obtained a valid lien by virtue of its possession prior to and at the time of filing the petition in bankruptcy (see Peter Schultler Co. v. Gunther, 222 Mich. 430, 192 N. W. 661, 49 Am. Bank. Rep. 678), and, if so, whether or not it waived this lien by reason of the surrender of the actual possession to the receiver."

Actually the decision of the United States Circuit Court of Appeals for the Ninth Circuit is in accord with all decisions of the United States Circuit Court of Appeals rendered in other Circuits. Judge Stephens in his opinion cites and agrees with the decision of the Second Circuit rendered in the case of *City of New York v. Hall*, (C. C. A. (2d) 1944), 139 F. (2d) 935. The decision follows the enunciation of principle laid down by the Third Circuit in the case of *In re Pennsylvania Central Brewery Co.* (C. C. A. 3, 1940), 114 F. (2d) 1010 (certiorari denied, 312 U. S. 685). There the Court in interpreting Section 67, subdivision (c) of the Bankruptcy Act stated:

> "If there is a statutory lien upon personal property not accompanied by possession or a distress for rent (which is always upon personal property) whether statutory or not, such liens are postponed in payment to expenses of administration and wage claims."

The Fifth Circuit in the case of *City of New Orleans v. Harrell* (C. C. A. 5, 1943), 134 F. (2d) 399, at page 401, in interpreting the effect of Section 67, subdivision (c) of the Bankruptcy Act on a lien claim refers to the class in which the Collector of Internal Revenue finds himself in the instant case, that is "a special class of secured creditors whose claims are postponed in payment to the debts specified in clauses (1) and (2) of Section 64, sub. a of said Act."

Respondent knows of no case decided by the Circuit Court of Appeals contrary to the decision rendered by the Ninth Circuit in the instant case.

C. The decision of the Circuit Court of Appeals for the Ninth Circuit is completely in accord with the letter and spirit of the Bankruptcy Act and not in conflict with

it. The Congress in 1938 when it amended the Bankruptcy Act sought to further protect the wage claims of unpaid employees of a bankrupt and the decision follows this intent.

The background of this legislation is set forth in Collier on Bankruptcy, 14th ed., Vol. 4. At page 157 it states:

> "And under the Act of 1898 all liens valid in bankruptcy had precedence over unsecured claims entitled to priority under Sec. 64: only after the discharge of such liens were assets available for distribution, first to priority claimants, and second to other unsecured creditors having no priority. This general principle remains true under the Act of 1938, subject to the fact that Sec. 67c subordinates statutory liens under certain circumstances to debts having first and second priority under Sec. 64."

At page 235 it states:

> "The function of Sec. 67c is entirely different. In effect Sec. 67c says that *statutory* liens on personal property not accompanied by possession, and liens, whether statutory or not, of distress for rents, regardless of possession, are inferior to *all* administrative costs and expenses of the bankruptcy proceeding and *wage claims*, which are entitled, respectively, to a first and second priority under Sec. 64a. This principle whereby certain liens are subordinate to certain priorities is new to bankruptcy law, being first introduced by the Act of 1938. It is a statutory principle which Congress introduced to provide a measure of much-needed protection, . . . (2) for wage claims in the interest of protecting a weak but deserving economic class, against the ravages of certain accumulated liens on the bankrupt's property." (Emphasis theirs.)

Conclusion.

We respectfully urge that the petition filed herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit be denied.

Respectfully submitted,

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IN THE

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No. 35

35

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation,

Petitioner,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, Statutory Assignee of Certain Prior Wage Claimants,

Respondent.

BRIEF OF THE RESPONDENT.

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Petitioner,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, Statutory Assignee of Certain Prior Wage Claimants,

Respondent.

BRIEF OF THE RESPONDENT.

Opinion Below.

The opinion of the Court of Appeals for the Ninth Circuit [R. 36-39] is reported at 165 F. 2d 155. The District Court did not file a written opinion.

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was entered December 9, 1947 [R. 39-40]. The petition of the trustee in bankruptcy for a writ of certiorari was filed March 9, 1948, and the writ was granted by this Court on March 24, 1948.

Statutes Involved.

The principal statute involved is Section 67(c) of the Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

Section 67(c) (United States Code, Title 11, Chap. 7, Sec. 107): Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act.

Other statutes involved generally are set forth at pages 20-24 in the Appendix of the brief of the United States, and for purposes of brevity are not here repeated.

Question Presented.

By virtue of the provisions of Section 67(c) of the Bankruptcy Act, do the prior wage claimants have priority in payment from the funds remaining in the hands of the trustee in bankruptcy over the statutory lien claim of the Collector of Internal Revenue, where such funds came into the bankrupt estate through sale in the bankruptcy proceeding of personal property voluntarily relinquished by the Collector of Internal Revenue to the receiver in bankruptcy?

Statement of Case.

The facts in this case are precisely as set forth in the STATEMENT on pages 6-9 of the petition for writ of certiorari filed by the trustee in bankruptcy. For emphasis respondent will repeat the trustee's words here:

> "The facts in the case at bar are undisputed.
>
> "The appellant below, respondent herein, accepted as the statement of facts the recitation contained in the certificate of the referee on petition for review in connection with the appeal by the said appellant to the District Court, and from this certificate we quote as follows [Record before Appellate Court, pp. 26-28]:
>
> "'This proceeding began on March 26, 1946. On that date all of the assets, later liquidated by the trustee, were in the physical possession of the Collector of Internal Revenue. The Collector had previously made a seizure of the said assets pursuant to certain tax claims against the bankrupt, which tax claims are specifically described in Exhibit "A" of your Referee's findings of fact, conclusions of law and order, a true copy of which is going up with this certificate. In addition to having made a physical seizure of the said assets, the Collector of Internal Revenue, prior to the commencement of this bankruptcy proceeding, had filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit "A". Pursuant to his legal rights and remedies, by virtue of the said seizure, the Collector of Internal Revenue had conducted a sale of the said assets and had received bids thereon, but the said sale was not completed because the price obtainable was unsatisfactory to the Collector. A second sale by the collector was instituted but was abandoned when the said assets were relinquished to the receiver in this matter, as hereinafter set forth.

"'On March 26, 1946, the day this proceeding began, George T. Goggin, now trustee, was appointed receiver in this matter. He qualified as such receiver on March 28, 1946. Upon his appointment and qualification, the said receiver contacted the office of the Collector of Internal Revenue and conversations were had between the receiver and counsel in the Los Angeles office of the Collector relating to the turning over of the said assets by the Collector to the receiver. Thereafter, the following telegram was received by the Los Angeles office of the Collector of Internal Revenue from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue:

> "'"Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale.
>
> J. P. Wenchel
> Chief Counsel"

"'The contents of the said telegram were imparted by telephone to the office of the said receiver. No formal acceptance or acknowledgment thereof was made by the receiver. No notice of the telegram or of its contents was given to any of the creditors or other parties in interest in this matter and no notice thereof was given at the time of the trustee's sale of the aforesaid assets. After the said telegram had been imparted to the office of the said receiver, as aforesaid, the said receiver, with full knowledge of the said telegram and of its contents and without any objection thereto, took over the possession of the said assets from the Collector of Internal Revenue. Later

the said receiver, in his capacity as trustee, caused the said assets to be sold at public auction, pursuant to the order of this Court.'

"On October 17, 1946, the petitioner herein filed a petition for order to show cause *re*: Tax & Labor Claimants; dated October 4, 1946, and, pursuant to this petition, an order to show cause was duly issued by the Referee in Bankruptcy on October 18, 1946, directing the various tax and labor claimants to show cause why the said referee should not determine the priority and method of payment of the expenses of administration, tax claimants, and prior labor claimants. Hearing was duly had thereon upon the 30th day of October, 1946; thereafter, the Referee duly signed findings of fact, conclusions of law and an order, finding as follows:

"1. That from the monies in the possession of George T. Goggin, as trustee, there shall first be paid the expenses of administration.

"2. That after the payment of the expenses of administration, the balance of the funds then in the hands of the trustee should be paid to the Collector of Internal Revenue in partial payment of the tax claim for which he had filed and recorded a lien and had seized actual possession of personal property involved, prior to the commencement of the bankruptcy proceeding; the amount of said lien and seizure claims being more than the total of the funds in the hands of the trustee arising from the sale of the physical assets.

"The respondent herein, the Division of Labor Law Enforcement for the State of California, filed a petition for review from the order of the referee and the matter was duly heard before the district judge below.

and the Honorable Campbell E. Beaumont, as said District Judge, duly made and entered an order, on May 21, 1947, confirming the order of the referee above referred to entered on December 12, 1946, and adopting the findings of fact and conclusions of law of the referee.

"From the order of the District Judge the Division of Labor Law Enforcement for the State of California duly filed a notice of appeal and the matter was presented to the United States Circuit Court of Appeals for the Ninth Circuit and finally determined on December 9, 1947, by an opinion filed on that date. This opinion reversed the order of the referee and the District Judge and directed the referee to allow the labor claims represented by the Division of Labor Law Enforcement for the State of California as prior claims to be paid before paying any monies to the Collector of Internal Revenue on behalf of the United States of America, and petitioner now seeks review by certiorari."

Respondent takes issue with and objects to that portion of the statement of the facts in this case as set forth in the STATEMENT of the brief for the United States on page 3, to wit:

"Upon his appointment and qualification, conversations were had between the receiver and counsel in the office of the Collector as to turning over to the receiver the bankrupt's personal property in the Collector's possession. [R. 18.] Pursuant to these conversations, the assets were turned over to the receiver *who accepted the terms and conditions of a telegram from J. P. Wenchel*, Chief Counsel of the Bureau of Internal Revenue, reading as follows [R. 7]:" (Emphasis ours.)

Both Mr. Martin Gendel, counsel for petitioner, and Mr. Edward M. Belasco, counsel for respondent; were present in the courtroom of the referee in bankruptcy at the hearing on October 30, 1946, when the facts were agreed upon, and throughout all appellate proceedings thereafter petitioner and respondent have accepted the statement of facts rendered by the referee in bankruptcy in his certificate as being true and correct; both parties have included the referee's words in their briefs. These words are:

> "The contents of the said telegram were imparted by telephone to the office of the said receiver. No formal acceptance or acknowledgment thereof was made by the receiver. No notice of the telegram or of its contents was given to any of the creditors or other parties in interest in this matter and no notice thereof was given at the time of the trustee's sale of the aforesaid assets."

Summary of Argument.

Section 67(c) of the Bankruptcy Act created priority payment rights for prior wage claims not hitherto granted under bankruptcy law, and the Collector of Internal Revenue became subject to the provisions of that section when he voluntarily entered the bankruptcy proceedings.

Any private agreement between the Collector of Internal Revenue and the receiver or trustee in bankruptcy concerning the attachment of the statutory lien to the proceeds of a trustee's sale, when possession of the personal property was voluntarily transferred to the receiver, would not be binding upon the prior wage claimants.

Under Section 67(c) of the Bankruptcy Act, administration costs and prior wage claims are jointly given priority over statutory liens not accompanied by possession.

ARGUMENT.

I.

Section 67(c) of the Bankruptcy Act Created Priority Payment Rights for Prior Wage Claims Not Hitherto Granted Under Bankruptcy Law, and the Collector of Internal Revenue Became Subject to the Provisions of That Section When He Voluntarily Entered the Bankruptcy Proceeding.

The first thing to be considered is that the Collector of Internal Revenue could have avoided this controversy by accepting the bid offered at his first lien sale or conducting his second, and possible subsequent sales, until he received a bid acceptable to him. Under the rule of *Stratton v. New*, 283 U. S. 318, the trustee could have appeared in the sale proceeding and seized for the estate any balance of the proceeds after the lien had been satisfied. The Collector of Internal Revenue did not see fit to do this, but instead entered the bankruptcy proceeding by consent. The effect of his appearance is set forth in Section 2195, Remington on Bankruptcy, 4th ed., Vol. 5, page 330:

> "Jurisdiction may be conferred on the bankruptcy court by the defendant's consent in cases wherein otherwise it has no jurisdiction, and if adverse claimants in possession of the property who would not otherwise be within the jurisdiction of the bankruptcy court, nevertheless voluntarily surrender custody of the property, or consent to the jurisdiction of the bankruptcy court, the question of ownership and all other questions in relation thereto, as, for instance, the extent, validity and priority of liens upon and interests in the property, may be tried out in the bankruptcy proceedings."

As the referee stated in his certificate, the Collector of Internal Revenue voluntarily relinquished possession of the physical assets to the receiver, who later, in his capacity as trustee, sold the assets at public auction. Possession by the trustee was not possession by the Collector of Internal Revenue, since the trustee was not the agent for the Collector of Internal Revenue but, as an officer of the Court, represented all the creditors. It was held in the case of *In re San Joaquin Valley & Packing Co.*, 295 Fed. 311, that the trustee was not trustee for the fully secured lien claims; he was trustee for the bankrupt and the unsecured creditors; that in bankruptcy proceedings these two classes of creditors stood upon a different footing, and that it was not necessary for the fully secured lien creditor to prove his claim, but he would subject the security or its proceeds to the payment of the lien.

As was stated in the brief of the United States in its first argument, pages 6-8, at the commencement of the bankruptcy proceedings, the priority of the lien of the United States over wage claims was clearly established. Respondent has never contended that Section 67(c) of the Bankruptcy Act in any way altered the full force and effect of the Collector's lien; it was valid before bankruptcy and after bankruptcy proceedings commenced. Had the receiver or trustee in bankruptcy obtained a Court order from the referee in bankruptcy and taken over the personal property of the bankrupt from the possession of the Collector of Internal Revenue, respondent would not maintain that the Collector of Internal Revenue lost the element of possession necessary to prevent the application of Section 67(c) of the Bankruptcy Act; in such case the possession of the lien claimant would be fixed and continuing before and after the commencement of the bank-

ruptcy proceeding. It is established law that when the bankruptcy court takes property from a lien holder and holds a sale of the property in the bankruptcy proceeding, the proceeds of the sale, less the trustee's reasonable expenses in conducting the sale must first satisfy the lien as against all creditors. In such a case the lien holder by force of Court order is before the bankruptcy court and his substantive rights cannot be altered.

But, as in this case, where the lien holder by his voluntary act and for his own reasons enters the bankruptcy proceedings, makes use of the bankruptcy court processes, makes use of the time and efforts of the receiver or trustee in bankruptcy and avoids the expense and bother of conducting his private lien sale outside the bankruptcy proceedings, the lien holder cannot avoid the full consequences of his voluntary act.

Judge Stephens in the opinion below gave consideration to this concept of law, stating:

> "In the instant case the government had actual possession, but it surrendered that possession by virtue of a bargain with the receiver without taking into account the wage and creditor claimants. The Act provides that wage claims come ahead of the government lien in distribution of the proceeds of sale of property not in possession of the government lien holder. The government lien holder must either sell the property under its lien or eventually surrender it into the bankruptcy proceedings. We find no authority whatever for the proposition that the government can turn the property over to the trustee under a consent based upon the receiver's assurance that the lien shall continue upon the property and also upon the money it may bring when sold as a part of the bankruptcy estate. It is our opinion that the wage claim-

ants had certain statutory rights at the inception of the bankruptcy proceedings, and such rights remained throughout the proceedings, modified by the actual possession of the assets. The fact, as is claimed, that the receiver could make the sale to better advantage is irrelevant, for the question is one of power and not of business judgment. The statutory requirements may not be disregarded through private agreements which affect others' rights without their consent."

Respondent urges that the Court below gave full credence to the intent of Congress in enacting Section 67c of the Bankruptcy Act. It was a matter of common knowledge that tax claims were consuming most of the assets in bankrupt estates to the exclusion of court costs and prior labor claims. In most instances the toil and labor of the employees of the bankrupt created or preserved those assets and in order to protect this innocent and deserving group Congress subordinated payment of certain lien claims, including statutory liens on personal property not accompanied by possession. The background of this legislation is set forth in Collier on Bankruptcy, 14th ed., Vol. 4. At page 157 it states:

"And under the Act of 1898 all liens valid in bankruptcy have precedence over unsecured claims entitled to priority under Sec. 64: only after the discharge of such liens were assets available for distribution, first to priority claimants, and second to other unsecured creditors having no priority. This general principle remains true under the Act of 1938, subject to the fact that Sec. 67c subordinates statutory liens under certain circumstances to debts having first and second priority under Sec. 64."

At page 235 it states:

> "The function of Sec. 67c is entirely different. In effect Section 67c says that *statutory* liens on personal property not accompanied by possession, and liens, whether statutory or not, of distress for rents, regardless of possession, are inferior to *all* administrative costs and expenses of the bankruptcy proceeding and wage claims, which are entitled, respectively, to a first and second priority under Sec. 64a. This principle whereby certain liens are subordinate to certain priorities is new to bankruptcy law, being first introduced by the Act of 1938. It is a statutory principle, which Congress introduced to provide a measure of much-needed protection, . . . (2) for wage claims in the interest of protecting a weak but deserving economic class, against the ravages of certain accumulated liens on the bankrupt's property." (Emphasis theirs.)

When the Collector of Internal Revenue entered the bankruptcy proceeding by consent and gave up possession of the property to the receiver, the statutory rights of the prior wage claimants to payment of their claims payment on the lien claims became fixed.

The facts show that the Collector *lost actual possession*. It was determined by the Court below and the Second Circuit in *City of New York v. Hall*, 139 F. 2d 935, that possession as used in Section 67c in the Bankruptcy Act means actual possession, not constructive possession. The brief of the United States alleges that the purpose of the requirement of possession is merely to give notice to employees that the property levied upon will not be available to satisfy wage claims. Respondent contends there is no reason or merit to such an argument, because notice or lack of notice means absolutely nothing to the ordinary

worker whose sole interest is to maintain his job by satisfying the demands of his employer and bringing home his pay check in order to feed and clothe his family. The worker does not care whether there has been a lien on his employer's property with or without possession, so long as he can stay on the job, his immediate concern is whether he is going to get his wages. Actually, the workers are in the most helpless position of all creditors, and Congress in the Bankruptcy Act and the various states in insolvency statutes have created laws attempting to protect this class. This Court has this month denied issuance of a writ of certiorari in the case of *Check v. The Division of Labor Law Enforcement,* ..... U. S. ....., and by so doing upheld a California statute granting lien rights to unpaid workers whose employer has made an assignment for the benefit of creditors. Congress in enacting Section 67c of the Bankruptcy Act merely added to and strengthened the priority payment rights of the employees of a bankrupt employer.

Both petitioner and the United States cite *Petition of International Harvester Co.*, 9 F. 2d 299 (C. C. A. 6), in which the court held that waiver of a prior lien could not be implied solely from the fact that a lienholder in possession surrender possession to the receiver after the filing of the petition in bankruptcy. The case is easily distinguished from the instant case in that no contention is made here that the Collector's lien was waived by his surrender of possession; all that the respondent is contending is that the lien, though valid after the surrender of possession, was deferred in time of payment to the prior wage claimants in accordance with the provisions of law.

II.

Any Private Agreement Between the Collector of Internal Revenue and the Receiver or Trustee in Bankruptcy Concerning the Attachment of the Statutory Lien to the Proceeds of a Trustee's Sale, When Possession of the Personal Property Was Voluntarily Transferred to the Receiver, Would Not Be Binding Upon the Prior Wage Claimants.

The Collector of Internal Revenue and the receiver in bankruptcy in the instant case made a private business arrangement; respondent in no way questions the propriety of such an arrangement and believes that it was honest and intelligent business practice. As a result of this business deal the bankrupt's property was sold for over $40,000.00 instead of $23,000.00, and the receiver in his capacity as trustee was enabled to earn fees legally due him. It was when the Collector of Internal Revenue attempted to use the terms of this private agreement in circumvention of statutory rights of the prior wage claimants that respondent entered the scene and has been vigorously fighting this contention ever since. Other than a case decided in a district court, *In re Lebed*, 35 Fed. Supp. 457, respondent knows of none other touching on this point in connection with Section 67c of the Bankruptcy Act. In that case a landlord's lien was involved rather than a tax lien. Two landlords, acting through a constable with a landlord's warrant, levied upon and seized the stock and fixtures of the debtor for accrued rent. Sale was stayed at the request of certain, but not all, of the creditors to permit the filing of an involuntary petition in bankruptcy. It was

then agreed that the landlords should have a lien on the funds derived from the sale in the hands of any receiver or trustee to the same extent as if they, the landlords, had exercised their right of sale prior to bankruptcy. The matter arose on a petition to review the order denying full priority to the landlords. The Court stated in part:

> "Finally the effect of the prebankruptcy agreement between the petitioners and certain of the creditors must be considered. . . . In the trustee's brief it is admitted 'had the landlord proceeded under the levy, there would not have been sufficient time within which to secure the necessary signers to an involuntary petition in bankruptcy before the sale could have been held by the landlord. Had he actually enforced the sale he would have had his money and the controversy would not have arisen. The fact is that the request for the extension has been greatly to benefit the bankrupt estate. The receiver sold the stock which had been levied upon for $1,800.00, but had the constable sold the same goods, it is extremely doubtful if a fund more than required to pay the landlord's claim of $540.00 would have been raised, so that from a strictly practical viewpoint, the bankrupt estate could pay the landlord's claim and still be more than a $1,000.00 ahead. The landlord is being penalized for the courtesy which was extended to present counsel for the trustee. The trustee, however, has a duty to perform to all of the creditors, and to submit the matter to the court with the fairest statement of facts possible.' In my opinion claimants are entitled to full priority for payment as against

those creditors who induced them to forego their right of sale under the agreement that their rights should be the same as if sale had been held. Of course, the rights of the other non-consenting creditors could not be affected by this agreement and, as to them the trustee's distribution of the assets should conform strictly with the provisions of the Bankruptcy Act."

On page 27 of his brief petitioner attempts to distinguish the *Lebed* case on the grounds that it involves a landlord's lien and the agreement was made before the commencement of the bankruptcy proceeding, whereas in the instant case the agreement was made after the commencement of the bankruptcy proceeding. Respondent does not believe that this argument should be given weight, since the principle of law established in the *Lebed* case is simply that under the provisions of Section 67c of the Bankruptcy Act non-consenting creditors are not bound by private agreements between lienholders and other creditors or the receiver or trustee in bankruptcy.

The Court below in its opinion fully considered the principle which respondent is here urging and stated:

"The statutory requirements may not be disregarded through private agreements which affect others' rights without their consent."

III.

Under Section 67(c) of the Bankruptcy Act, Administration Costs and Prior Wage Claims Are Jointly Given Priority Over Statutory Liens Not Accompanied by Possession.

Freeman Furniture Factories, Inc., v. Bowlds, 136 F. 2d 136, holds that where a creditor having a statutory lien invokes the jurisdiction of the bankruptcy court by joining in an involuntary petition in bankruptcy and by participating in proceedings for bankruptcy sale of assets in order to realize on the security, the costs of administration are properly chargeable to the fund produced by such sale, and the lien creditor cannot claim priority over such administration costs if there is no general fund free from liens for the benefit of the estate.

A like situation exists in the case at bar.

Respondent urges that the provisions of Section 67c of the Bankruptcy Act are mandatory upon a referee in bankruptcy in the case of statutory liens. The lien holder, where there is a sale free of liens and encumbrances, is chargeable with the actual costs of the sale plus costs reasonably incurred in the preservation of the property and the proportion of administration expenses that may be attributed to the sale. But respondent contends that in the case of statutory liens, where there has been a consent to jurisdiction of the bankruptcy court and a surrender of possession of the property, Section 67c of the Bankruptcy Act requires that *all* administrative costs and all prior wage claims come first in payment.

Since the referee allowed all expenses of administration as a priority over the Collector of Internal Revenue's lien, he was obliged to grant all prior wage claims the same priority. Such tortured reasoning as is used by the referee

in his certificate, "Your referee construed the words, 'Trustee's expenses, including costs of sale,' to mean the expenses of administration in the case, as allowed by the court," cannot circumvent the effect of a specific law of the Congress. The words of the act state, ". . . shall be postponed in payment to the date specified in Clauses (1) and (2) of Subdivision a of Section 64 of this Act, . . ." and no other meaning is apparent, except that these classes of debts are treated in the conjunctive; having allowed priority to one class of debt the referee must allow priority to the other.

Conclusion.

The Court of Appeals for the Ninth Circuit has held that the Collector of Internal Revenue must pay the legal price for voluntarily entering the bankruptcy proceeding. It is respectfully urged that the decision of the Court of Appeals for the Ninth Circuit should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 35

GEORGE T. GOGGIN, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF KESSCO ENGINEERING CORPORATION, PETITIONER

v.

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE OF CERTAIN PRIOR WAGE CLAIMANTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court did not file a written opinion. It adopted the findings of fact and conclusions of law of the referee in bankruptcy (R. 5-9, 23). The opinion of the Circuit Court of Appeals (R. 36-39) is reported at 165 F. 2d 155.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 9, 1947. (R. 39-40.) The petition of the Trustee in Bankruptcy for a writ of certiorari was filed March 9, 1948, and was granted March 29, 1948. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (now 28 U.S.C. 1254), and under Section 24(c) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840.

QUESTION PRESENTED

Where the Collector of Internal Revenue, on behalf of the United States of America, has recorded tax liens, and pursuant thereto and prior to bankruptcy has taken actual possession of personal property of a bankrupt, does Section 67(c) of the Bankruptcy Act require subordination of the United States' tax liens to wage claims by reason of the Collector's surrender of possession of such personal property to the receiver in bankruptcy under an agreement that, subject to "Trustee's expenses, including costs of sale", the proceeds from the sale of such property will be first devoted to the payment of the liens of the United States?

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 20-24.

STATEMENT

The facts are undisputed. Prior to the commencement of bankruptcy proceedings herein, on March 26, 1946, the Collector of Internal Revenue had filed notices of tax liens and had actual possession of all of the bankrupt's assets, having made a seizure to collect tax claims of the United States. (R. 6, 16, 17.) He had conducted a sale of these assets and had received bids thereon, but the sale was not completed because the price offered was unsatisfactory. A second sale was instituted but was abandoned when the assets of the bankrupt were relinquished to the receiver, as hereinafter set forth (R. 18). On March 26, 1946, the day this proceeding began, George T. Goggin, now Trustee, was appointed receiver in bankruptcy. Upon his appointment and qualification, conversations were had between the receiver and counsel in the office of the Collector as to turning over to the receiver the bankrupt's personal property in the Collector's possession. (R. 18). Pursuant to these conversations, the assets were turned over to the receiver who accepted the terms and conditions of a telegram from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, reading as follows (R. 7):

> Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, Bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to

attach to proceeds from sale subject to Trustee's expenses including costs of sale.

Later the receiver, in his capacity as trustee, sold the bankrupt's assets at public auction, pursuant to order of the Bankruptcy Court (R. 19), realizing approximately $31,206.20 (R. 7), which is less than the amount of the Government's lien claims for taxes (R. 6). Wage claims in the amount of $3,424.87 were filed for services rendered to the bankrupt within ninety days of bankruptcy (R. 21-22). The Division of Labor Law Enforcement of the State of California appeared on behalf of all wage claimants. (R. 7). Upon the Trustee's petition (R. 3-4), an order to show cause was duly issued herein directing the various claimants to show cause why the referee should not determine the priority and method of payment of the expenses of administration, tax claims, and labor claims (R. 4-5). After a hearing, the referee made the above findings of fact and ordered that the moneys in possession of the Trustee, consisting solely of the proceeds from the sale of the personal property previously in the possession of the Collector, be first used to pay the expenses of administration; and that after the payment of administration expenses the balance of the funds should be paid to the Collector on behalf of the United States in partial payment of the federal tax claims, which the referee concluded were a lien superior to all other claimants (R. 8, 16).

The Division of Labor Law Enforcement of the State of California filed a petition for review of the order of the referee (R. 10-15) and the matter was heard by the district court upon the referee's certificate (R. 15-19, 21-22). The district court adopted the findings of fact and conclusions of the referee (R. 23). Upon appeal by the Division (R. 30-31), the United States Circuit Court of Appeals for the Ninth Circuit, on December 9, 1947, reversed the order of the district court and directed payment of the wage claims before payment of the tax liens of the United States. Specifically, the court below held that, under Section 67(c) of the Bankruptcy Act, the relinquishment, after the filing of the bankruptcy petition, of possession of the bankrupt's personal property subject to the tax liens, required subordination of the tax liens to the wage claims (R. 36-39). The case is before this Court upon the Trustee's petition for certiorari which was granted on March 29, 1948.[1]

SUMMARY OF ARGUMENT

Prior to the commencement of the bankruptcy proceedings, the United States had perfected liens for unpaid federal taxes and had also taken actual possession of the bankrupt's personal property. Section 67(c) of the Bankruptcy Act subordinates tax liens on personal property to administration

[1] As the lien of the United States exceeds the proceeds available, it is the sole real party in interest in opposition to the wage claims. This brief is filed in support of the interest of the United States.

expenses and to limited wage claims unless such liens have been enforced by sale prior to the filing of the petition or are accompanied by possession of such personal property. The sole purpose of the alternative requirement of possession of the personal property subject to the lien, is to warn employees and potential petitioning creditors that such assets will not be available for payment of their claims and expenses. This purpose is fully served where the United States has taken actual possession of the bankrupt's personal property prior to the filing of the petition. Where, after the filing of the petition, the Collector delivers such personal property to the referee in bankruptcy for the purpose of a more advantageous sale and with the express understanding that the lien of the United States should attach to the proceeds, nothing in the language or purpose of Section 67(c) requires subordination of the lien of the United States. Considerations of fair and effective bankruptcy administration require that tax authorities should be encouraged to make the most advantageous sale of the bankrupt's personal property, rather than penalized for doing so.

ARGUMENT

I

AT THE COMMENCEMENT OF THE BANKRUPTCY PROCEEDINGS, THE PRIORITY OF THE LIEN OF THE UNITED STATES FOR TAXES OVER WAGE CLAIMS WAS CLEARLY ESTABLISHED.

Prior to the commencement of the bankruptcy proceedings, the United States had perfected its

lien for unpaid federal taxes. It was well settled under the Bankruptcy Act before its revision by the Act of June 22, 1938, the so-called Chandler Act, that liens against a bankrupt's property which were valid under either federal or state law remained valid on the property in the hands of the trustee after bankruptcy unless invalidated by some provision of the Act itself. See *Straton* v. *New*, 283 U. S. 318; *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 (C.C.A. 9th). This fundamental principle was not changed by the Chandler Act. *In re Van Winkle*, 49 F. Supp. 711, 713 (W.D. Ky.); *Reconstruction Finance Corp.* v. *Sun Lumber Co.*, 126 F. 2d 731 (C.C.A. 4th). Also, prior to the Chandler Act, all liens valid in bankruptcy had precedence over unsecured claims entitled to priority under Section 64 of the Act (*City of Richmond* v. *Bird*, 249 U. S. 174), and this general principle was preserved by the 1938 amendments except as modified by Section 67(c) (Appendix, pp. 21-22, *infra*). 4 Collier on *Bankruptcy* (14th ed. 1942), pp. 157-158. Subsection (b) of Section 67 of the Bankruptcy Act (Appendix, p. 21, *infra*), specifically provides that statutory liens for taxes owing to the United States may be valid against the trustee even though arising or perfected while the debtor is insolvent and within four months prior to bankruptcy.

Subsection (c) of Section 67 generally provides that statutory liens (including liens for federal taxes) on personal property not accompanied by possession of such property, though valid under

subsection (b) of Section 67, shall be subordinated to the administration expenses and wage claims enumerated in clauses (1) and (2) of Section 64(a).[2] It is undisputed that the Collector had seized all of the personal property of the bankrupt prior to the filing of the petition and that he had possession of the property on the date the bankruptcy petition was filed. Thus, on that date the lien of the United States was clearly unaffected by Section 67(c), and was therefore paramount to all unsecured claims—including administration expenses and wage claims.

II

WHERE, AFTER THE COMMENCEMENT OF BANKRUPTCY PROCEEDINGS, THE COLLECTOR RELINQUISHED POSSESSION OF PERSONAL PROPERTY SUBJECT TO THE TAX LIEN OF THE UNITED STATES TO THE TRUSTEE IN BANKRUPTCY FOR THE PURPOSE OF OBTAINING A MORE ADVANTAGEOUS SALE, UPON THE EXPRESS UNDERSTANDING THAT THE SALE PROCEEDS SHOULD BE SUBJECT TO THE LIEN, SECTION 67(c) SHOULD NOT BE INTERPRETED TO REQUIRE SUBORDINATION OF THE UNITED STATES' LIEN TO ADMINISTRATION EXPENSES AND WAGE CLAIMS.

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[2] It is the Government's position that subsections (b) and (c) do not apply to statutory liens perfected more than 4 months prior to bankruptcy. Consequently, federal tax liens perfected before that time are valid in bankruptcy even though unaccompanied by possession. In the present case, the total federal tax claims supported by liens perfected prior to 4 months before bankruptcy do not equal the sum to be distributed. This fact, however, ascertained from official U. S. Treasury records, does not appear in the record of this case. Consequently, the inapplicability of Section 67(c) to a portion of the federal taxes here in question was not raised below and the decisions of the trial and appellate courts do not refer to this factor. The issue here, therefore, proceeds on the basis of applying Section 67(c) to the full amount of the federal tax claims involved.

(A) The purpose of Section 67(c) is to give warning of the existence of liens, and this purpose is fully satisfied where the lien of the United States upon the bankrupt's personal property was accompanied by actual possession of such property at the commencement of the bankruptcy proceedings.

The date on which the petition in bankruptcy is filed is the time as of which the rights and priorities of creditors are determined. *United States* v. *Marxen*, 307 U. S. 200, 207-208; *Myers* v. *Matley*, 318 U. S. 622, 626. On that date, the right of the United States to satisfy its lien from the bankrupt's personal property was founded upon actual possession of such property. Nothing in Section 67(c) suggests that the tax lien of the United States is to be subordinated if personal property of the bankrupt which was in the possession of the United States at the commencement of the bankruptcy proceedings is later relinquished. The subsection provides that "Where not enforced by sale before the filing of a petition * * *, statutory liens, including liens for taxes or debts owing to the United States * * *, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to [administration expenses and claims for wages earned within three months prior to the commencement of the proceedings up to $600 for each wage claimant]." Prior to the 1938 revision of the Bankruptcy Act,

tax liens otherwise valid took precedence over unsecured claims regardless of whether the Government had levied upon the property subject to its lien. This is still the rule with respect to real property subject to a tax lien. *In re Pennsylvania Central Brewing Co.*, 114 F. 2d 1010, 1012 (C.C.A. 3d), certiorari denied, 312 U. S. 685. Accordingly, it is to be presumed that the limited subordination first provided by Section 67(c), restricted as it is, in addition to rent liens, to statutory liens upon personal property only, was drafted to meet a specific problem. The legislative history of Section 67(c) indicates that such was the case.

Section 67(c) apparently originated in the amendments proposed by the National Bankruptcy Conference. In a Committee Print Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936), prepared for the use of the House Committee on the Judiciary and containing amendments proposed by the Conference, the purpose of Section 67(c) is set forth (p. 212, note 1) and may be summarized as follows:[3] The policy of Section 64 is

[3] The full explanatory note reads: "Section 64 is declaratory of a policy that the costs and expenses in connection with a bankruptcy proceeding and its administration shall be first paid in distribution. It is a sound policy and is in accordance with the general principles well established in liquidation proceedings. But Section 67 of the Act does not apply the same limitation with respect to valid liens. The Supreme Court, in the case of *City of Richmond* v. *Bird*, 43 A.B.R. 260 (1919), resolved the conflict in the lower court decisions by holding that the priority provisions of Section 64 do not apply to liens valid under Section 67. The Fifth Circuit in the recent case of *City of Dallas* v. *Ryan*, 22 A.B.R. (N.S.) 378 (1933), following the law laid down in the *Bird* case, held that the

that bankruptcy administration expenses shall be paid first; however, liens must be satisfied ahead of all of the priority claims of Section 64. "Such claims, particularly tax liens, often consume the entire estate, leaving nothing for the payment of the costs and expenses of administration incurred in reducing the assets to cash. In many such cases the tax liens represent an accumulation of delinquent items covering a long period of time, without any attempt on the part of tax collectors to enforce payment prior to the bankruptcy proceeding. There is, therefore, need for a provision to protect the administration costs and expenses;

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priority provisions of Section 64 apply only to general unsecured claims, after the payment of specific liens and encumbrances; and that established liens obtained before bankruptcy and not invalidated by bankruptcy are not affected by that section.

"It is significant that in recent years state legislatures have been enacting special legislation in favor of tax claims, public debts, and a variety of private claims. Statistics in the bankruptcy cases show that the effective administration of the bankruptcy law has seriously suffered therefrom. Such claims, particularly tax liens, often consume the entire estate, leaving nothing for the payment of the costs and expenses of administration incurred in reducing the assets to cash. In many such cases the tax liens represent an accumulation of delinquent items covering a long period of time, without any attempt on the part of tax collectors to enforce payment prior to the bankruptcy proceeding.

"There is therefore need for a provision to protect the administration costs and expenses; and similar considerations apply to wage claims. Accordingly we have selected, from among the priorities fixed by Section 64 (as revised), these particular items for protection. However, by reason of the historical development and the inherent differences existing in the incidents attaching to real and personal property, it would seem advisable to restrict the remedy thus provided to liens on personal property, where such liens have not been enforced by sale prior to bankruptcy."

and similar considerations apply to wage claims." Thus "To afford protection to administrative costs and expenses and to wage claims, the authors of subdivision b [of Section 67], which expressly reaffirmed the validity of statutory liens, collaborated in a limited subordination of those liens". 4 Moore's Collier on *Bankruptcy* (14th ed.), 163-164.

It is significant to note that in an earlier draft of the recommendations of the National Bankruptcy Conference (House Judiciary Committee Print of May 15, 1935) in which this explanation first appears, tax liens on personal property would have been subordinated to administration expenses and wage claims if "not enforced by sale prior to bankruptcy" (pp. 175-176). This original proposal would have subordinated the tax lien where the personal property subject to the lien and already in possession of the Collector had not been sold prior to the filing of the petition. In that form, the saving exception for liens "enforced by sale" might reflect a policy of subordinating all tax liens to administration expenses and wage claims except to the extent necessary to protect innocent purchasers of the property.

The subsequent revision to save from subordination tax liens on personal property "accompanied by possession of such property" is nowhere explained, but it obviously adds a further condition under which there is to be no subordination of tax liens. As finally enacted, possession

prior to bankruptcy of personal property subject to the tax lien is as effective as the sale of such property to save the lien from subordination to administration expenses and wage claims. The purpose of this change appears to be independent of the aim to protect innocent purchasers where there has been a sale. That possession of personal property subject to a lien will save the lien from subordination suggests that the purpose of the possession requirement is to give notice (beyond the constructive notice of filing) that the property levied upon will not be available to satisfy administration expenses and wage claims. This function of possession as giving notice to potential petitioning creditors and employees is fulfilled by the time bankruptcy proceedings are commenced. Thus, nothing in the purpose and history of Section 67(c), as set forth above, suggests any exception to the general rule that rights are fixed as of the date of filing of the petition, or that the lien of the United States supported by actual possession on that date can thereafter be deprived of its status as a lien without the consent of the United States. This conclusion is confirmed by Weinstein, *The Bankruptcy Law of 1938* (1938), p. 145, ~~when~~ former one of the draftsmen of the Conference amendments states that "in respect even to personal property, the provisions [of Section 67(c)] are applicable only where the property has not been reduced to possession or where the liens have not been enforced by sale prior to bankruptcy."

The only case cited by the court below was *City of New York* v. *Hall*, 139 F. 2d 935 (C.C.A. 2d), as to which the court said, "We agree with the Second Circuit * * * in the holding that 'possession' as used in Section 67(c) means actual possession, the purpose being to protect and give warning to creditors. * * * Here we have a definite statutory provision based upon a well-understood reason limiting this lien to the actual possession of the property" (R. 38-39). However, the facts of that case, far from supporting the decision below, illustrate perfectly the more limited purpose of Section 67(c). There the City asserted in the bankruptcy proceeding a lien for taxes for seven years, although it had made no levy upon the bankrupt's personal property prior to the filing of the bankruptcy petition. Judge Frank there stated (p. 936):

> Whether steps taken pursuant to State "law" are sufficient to constitute "possession" under 67, sub. c, is a question of Federal "law". That conduct must adequately warn potential petitioning creditors of the existence of the lien. The City's action did not satisfy that test.

Obviously, the Second Circuit was simply holding that actual possession *at the time of bankruptcy* was necessary to avoid subordination of the tax liens. The clear implication of the decision is that Section 67(c) saves from subordination tax liens on personal property where the Government's

possession of the property gives notice to "*potential petitioning creditors* of the existence of the lien."

Where the taxing authority prior to bankruptcy takes actual possession of the personal property subject to its lien, other creditors and employees are warned that in the event of bankruptcy proceedings they cannot obtain reimbursement of their expenses (Section 64(a)(1)) or payment of their wage claims from such property. This notice or warning, to be effective, must consist of actual possession of the personal property prior to the filing of the petition. Once a bankruptcy petition has been filed, the requirement of actual possession has served its purpose; thereafter, neither the petitioning creditors nor wage claimants are misled or damaged in any way if the United States, for good reasons, arranges for sale by the trustee in bankruptcy of the bankrupt's property subject to its lien and which was in its possession when the petition was filed.

(B) *Sound considerations of business judgment and bankruptcy administration warranted the arrangement of sale by the trustee of the personal property subject to the lien.*

It should be noted at the outset that if the holding of the Court of Appeals below is permitted to stand it will thwart the release of physical possession of assets in the hands of the Collector of Internal Revenue for purposes of effecting a more

advantageous sale of the property, since the Collector has no authority to take any action which will result in a release or impairment of the lien of the United States for taxes. At the commencement of the bankruptcy proceeding, this lien was perfected and accompanied by possession of the bankrupt's personal property and was therefore paramount to all unsecured claims. Section 3671 of the Internal Revenue Code, which is here *in pari materia* with Section 67(c) of the Bankruptcy Act, provides that the lien of the United States for taxes "shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time". Congress has prescribed in detail the conditions under which a lien of the United States may be released. See Sections 3673-3676 of the Internal Revenue Code. None of these conditions exists here.

In any event, the Collector's actual possession of the personal property subject to the tax lien was not casually relinquished; rather, the property was turned over to the trustee pursuant to an express agreement that the sale proceeds should be subject to the lien. Consequently, whatever effect a casual release of possession by the Collector might be held to have, plainly in this case, where the release of possession was made on express conditions preserving the rights of the United States, there is no basis for inferring that its priority was waived. See *Petition of International Harvester Co.*, 9 F. 2d 299 (C.C.A. 6th), in which the court

held that a waiver of a prior lien could not be implied solely from the fact that the lienholder who had acquired possession of the property prior to bankruptcy surrendered possession to the receiver or trustee after the filing of the bankruptcy petition.

The action of the Collector in releasing the property was prompted by sound considerations of business judgment and bankruptcy administration. After the Collector had taken possession of the bankrupt's personal property, but prior to the filing of the bankruptcy petition, the Collector had conducted a sale of the property which was not completed because the bids were unsatisfactory. A second sale was being advertised by the Collector when he entered into the sale arrangement with the trustee which is here involved. It was the duty of the Collector to realize as much as possible from the sale of property so as to satisfy the claim of the United States for taxes. In many cases, since tax claims are not discharged by bankruptcy (Section 17 of the Bankruptcy Act), the bankrupt, if an individual, would be benefited by a sale which will reduce the tax claim as much as possible. The realization of a greater amount from the sale of assets would profit other lienors directly and all other claimants indirectly. If there are other assets in the bankrupt estate, an advantageous sale of the property subject to the tax lien benefits the general creditors to the extent that the tax claim is satisfied without recourse to such other assets.

Accordingly, where the Collector concludes that the trustee can make a more advantageous sale of the bankrupt's personal property, the exercise of such business judgment should be encouraged, rather than penalized by depriving the United States of the benefit of its lien. The result of the decision below will be to require all tax authorities (as well as the holders of other statutory liens) themselves to sell personal property levied upon to satisfy liens, so as to preserve the prior status of their liens, without regard to the possibility of a more advantageous sale by the trustee. Nothing in the Bankruptcy Act requires such a result.

To give effect to the agreement under which the sale here was made would be in accordance with established bankruptcy procedure. It has long been recognized that bankruptcy courts have power, upon the trustee's petition, to order the sale of property free from liens attaching to it and to transfer the liens to the proceeds of sale. *Van Huffel* v. *Harkelrode*, 284 U. S. 225; 4 Collier, *supra*, pp. 1597-1598. The lienholder commonly gives his consent, expressed or implied, to such sales and it is usual for the lienholder to bear his share of the cost of administration. 4 Collier, pp. 1604-1616. It is difficult to understand why the Trustee could not undertake to do precisely the same thing by arrangement with the lienholder having the prior right to the proceeds. It is true that the Bankruptcy Court had not authorized the Trustee to do so at the time the agreement was made but

the arrangement was later approved and adopted by the court when the order of the referee was affirmed by the court.

CONCLUSION

The decision of the Circuit Court of Appeals should be reversed with direction that it affirm the decision of the District Court.

Respectfully submitted,

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OCTOBER 1948.

APPENDIX

Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

SEC. 64. *Debts Which Have Priority.*—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis,

whole or part time, whether or not selling exclusively for the bankrupt; * * *.

* * * *

(11 U.S.C. 1940 ed., Sec. 104.)

SEC. 67. *Liens and Fraudulent Transfers.*— * * *

* * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII, or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter X, XI, XII, or

XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act.

* * * *

(11 U.S.C. 1940 ed., Sec. 107.)

Internal Revenue Code:

SEC. 3671. *Period of Lien.*

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1940 ed., Sec. 3671.)

SEC. 3673. *Release of Lien.*

Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax, may issue a certificate of release of the lien if—

(a) *Liability Satisfied or Unenforceable.*—The collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable by reason of lapse of time; or

(b) *Bond Accepted.*—There is furnished to the collector and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations.

(26 U.S.C. 1940 ed., Sec. 3673.)

SEC. 3674. *Partial Discharge of Property.*

(a) *Property Double the Amount of the Liability.*—Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax may issue a certificate of partial discharge of any part of the property subject to the lien if the collector finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the liability remaining unsatisfied in respect of such tax and the amount of all prior liens upon such property.

(b) *Part Payment.*—Subject to such regulations as the Commissioner, with the ap-

proval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax may issue a certificate of discharge of any part of the property subject to the lien if there is paid over to the collector in part satisfaction of the liability in respect of such tax an amount determined by the Commissioner, which shall not be less than the value, as determined by him, of the interest of the United States in the part to be so discharged. In determining such value the Commissioner shall give consideration to the fair market value of the part to be so discharged and to such liens thereon as have priority to the lien of the United States.

(26 U.S.C. 1940 ed., Sec. 3674.)

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